



# Pre-accession Economic Programme 2011 – 2013

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Macroeconomic Policy,  
Public Finances  
and Structural Reforms

**Ministry of Finance of the Republic of Macedonia**

Skopje, January 2011



The 2011 – 2013 Pre-Accession Economic Programme has been adopted by the Government of the Republic of Macedonia, on its 206<sup>th</sup> Session held on 25<sup>th</sup> of January, 2011.



## Content:

<b>List of Tables .....</b>	<b>5</b>
<b>List of Charts .....</b>	<b>5</b>
<b>List of Boxes .....</b>	<b>6</b>
<b>Preface .....</b>	<b>9</b>
<b>PART I General Macroeconomic Framework and Objectives .....</b>	<b>11</b>
<b>PART II Macroeconomic Developments .....</b>	<b>14</b>
2.1. Economic outlook.....	15
2.1.1. Recent macroeconomic developments .....	15
2.1.2. Recent developments in the financial system .....	30
2.2. Medium - term macroeconomic scenario.....	37
<b>PART III Public Finances .....</b>	<b>46</b>
3.1. General Government Budget Balance and Debt Stock .....	48
3.1.1. Actual State-of-Play and Medium-Term Expectations .....	48
3.1.2. Fiscal Strategy .....	53
3.1.3. Structural deficit.....	59
3.1.4. Public Debt Management .....	60
3.2. Sensitivity Analysis .....	65
3.2.1. Sensitivity Analysis of the Budget Deficit.....	65
3.2.2. Analysis of the sensitivity of public debt .....	67
3.3. Quality of public finances.....	68
3.4. Budgetary implications of "major structural reforms" .....	69
3.5. Sustainability of public finances .....	70
3.6. Institutional Features of Public Finance.....	71
<b>PART IV Structural Reforms .....</b>	<b>74</b>
4.1. Sector of the enterprises.....	75
4.2. Financial system.....	82
4.3. Labor market .....	88
4.3.1. Education.....	88
4.3.2. Labor market reform.....	93
4.4. Agriculture and agricultural policy .....	98
4.4.1. Agriculture and rural development.....	98
4.4.2. Forestry.....	100
4.4.3. Phytosanitary policy, food safety and veterinary policy.....	100
4.5. Administrative reform .....	105
4.5.1. Public administration reform .....	105
4.5.2. Improving transparency and accountability of the administration.....	106
4.5.3. Strengthening of the institutional capacities .....	107
4.6. Additional reform areas.....	108
4.6.1. Trade openness .....	108
4.6.2. Foreign Direct Investment.....	110
4.6.3. Market entry/exit .....	112
4.6.4. Rule of law and enforcement of contracts.....	113



4.6.5. Obstacles for trade with goods and services and cross-border investments .....	116
4.6.6. Customs System .....	117
4.6.7. Fiscal decentralization .....	118
4.6.8. Business Environment .....	121
4.6.9. Transport and electronic communication .....	124
<b>PART V Annexes .....</b>	<b>128</b>
Annex 1 Institutions and other organizations, from which opinion on the 2011- 2013 PEP was required, are the following: .....	129
Annex 2 Summary data to the Pre - accession economic Programme 2011 - 2013 .....	131



#### List of Tables:

<b>Table 2.1.</b>	International economic climate – selected macroeconomic indicators
<b>Table 2.2.</b>	GDP growth rates (production and expenditure methods)
<b>Table 2.3.</b>	Balance of payments' current account (in EUR millions)
<b>Table 2.4.</b>	Labor market developments
<b>Table 2.5.</b>	Gross Premium and Structure
<b>Table 3.1.</b>	Central Budget of the Republic of Macedonia
<b>Table 3.2.</b>	Consolidated general government budget
<b>Table 3.3.</b>	Deficit and sources of financing
<b>Table 3.4.</b>	Aggregate fiscal indicators and cycle
<b>Table 3.5.</b>	Stock of public debt
<b>Table 3.6.</b>	Sensitivity Analysis of the Budget Deficit
<b>Table 3.7.</b>	Index of interest costs on the basis of external public debt in the Budget of the Republic of Macedonia, when interest rates or foreign exchange rates change
<b>Table 4.1.</b>	Data for the companies in partial or complete state ownership
<b>Table 4.2.</b>	Market entry

#### List of Charts:

<b>Chart 2.1.</b>	Industrial production index
<b>Chart 2.2.</b>	Processing production index and level of capacity utilization
<b>Chart 2.3.</b>	Private transfers and their components
<b>Chart 2.4.</b>	Capital and financial account and its main components, in EUR million
<b>Chart 2.5.</b>	Gross external debt, by sectors (in EUR million)
<b>Chart 2.6.</b>	Inflation and energy and food prices (annual changes, in %)
<b>Chart 2.7.</b>	National Bank interventions on the foreign exchange market (in EUR million)
<b>Chart 2.8.</b>	Annual growth rates of the total deposits and credits to the private sector (in %)
<b>Chart 2.9.</b>	Compulsory pension funds portfolio
<b>Chart 2.10.</b>	Total turnover and MBI-10
<b>Chart 2.11.</b>	Real GDP growth and inflation rate
<b>Chart 2.12.</b>	GDP by expenditure method
<b>Chart 2.13.</b>	Employment elasticity
<b>Chart 2.14.</b>	TFP and labor productivity (growth rates)
<b>Chart 2.15.</b>	GDP gap (percentage difference from potential growth)
<b>Chart 2.16.</b>	Main assumptions in the projection of the balance of payments
<b>Chart 2.17.</b>	Current account (% of GDP)
<b>Chart 2.18.</b>	Trade deficit - energy and non-energy trade balance (% of GDP)
<b>Chart 3.1.</b>	Budget deficit in EU Member States and Republic of Macedonia
<b>Chart 3.2.</b>	Government Debt in EU Member States and Republic of Macedonia
<b>Chart 3.3.</b>	Current expenditure structure
<b>Chart 3.4.</b>	Structural budget balance
<b>Chart 3.5.</b>	Total public debt trends
<b>Chart 3.6.</b>	Guaranteed public debt
<b>Chart 3.7.</b>	Ownership structure of undue GS
<b>Chart 3.8.</b>	Eurobond issued by the Republic of Macedonia in 2009
<b>Chart 3.9.</b>	Sensitivity analysis of budget deficit
<b>Chart 3.10.</b>	Capital expenditures of the Budget of the Republic of Macedonia
<b>Chart 4.1.</b>	Degree of trade openness
<b>Chart 4.2.</b>	Special and total revenues in the period 2005-2009 (Denar million)



## List of Boxes:

### Box 1. Employment elasticity

## Abbreviations:

<b>ACCMIS</b>	Automated Court Case Management and Information System
<b>AEC</b>	Agency for Electronic Communications
<b>BERIS</b>	Business Environment Reform and Institution Strengthening Project
<b>CA</b>	Customs Administration
<b>CARDS</b>	Community Assistance to Reconstruction, Development and Stabilization
<b>CB bills</b>	Central Bank bills
<b>CCN</b>	Common Communication Network
<b>CDPS</b>	Customs Declaration Processing System
<b>CEA</b>	Center for Economic Analyses
<b>CEB</b>	Council of Europe Development Bank
<b>CEFTA</b>	Central European Free Trade Association
<b>cXML</b>	Common Lisp support for the Extensible Markup Language
<b>CSI</b>	Common System Interface
<b>CREST</b>	Scientific and Technical Research Committee
<b>EARM</b>	Employment Agency of the Republic of Macedonia
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EC</b>	European Community
<b>ECVET</b>	European Credit System for Vocational Education and Training
<b>EFTA</b>	European Free Trade Association
<b>EIB</b>	European Investment Bank
<b>IIICM</b>	European Information and Innovation Center in Macedonia
<b>ELEM</b>	Macedonian Power Plants
<b>EQARF</b>	European Quality Assurance Reference Framework
<b>ESA</b>	European System of Accounts
<b>ESFRI</b>	European Strategy Forum on Research Infrastructures
<b>ESC</b>	Economic and Social Council
<b>EU</b>	European Union
<b>EU "Traces"</b>	European Union Trade Control and Expert System
<b>EURES</b>	European Employment Services
<b>EXIM</b>	Single Window for Licenses for Import, Export and Transit of Goods and Tariffs Quotas in the Republic of Macedonia
<b>FDI</b>	Foreign Direct Investments
<b>FP</b>	Framework Programme
<b>FX</b>	Foreign Exchange
<b>GDP</b>	Gross Domestic Product
<b>GEM</b>	Global Entrepreneurship Monitor
<b>GIS</b>	Geographic Information System
<b>GFS</b>	Government Finance Statistics
<b>GRECO</b>	Group of States against Corruption
<b>GS</b>	Government Securities
<b>HACCP</b>	Hazard Analysis Critical Control Point
<b>HPP</b>	Hydro Power Plants
<b>IAIS</b>	International Association of Insurance Supervisors



<b>ICT</b>	Information and communication technologies
<b>IFIs</b>	International financial institutions
<b>IOSCO</b>	International Organization of Securities Commissions
<b>IPA</b>	The Instrument for Pre-Accession Assistance
<b>IPARD</b>	Instrument for Pre-Accession Assistance for Rural Development
<b>IT</b>	Information Technology
<b>ISCO</b>	International Standard Classification of Occupations
<b>ISO</b>	International Organization for Standardization
<b>KfW</b>	Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute)
<b>LAG</b>	Local Action Groups
<b>LEADER</b>	Liaisons Entre Actions de Developpement de l'Economie Rurale'
<b>LDBIS</b>	Legal Database Information System
<b>LGU</b>	Local Government Units
<b>LRIC</b>	Long-Run Average Incremental Cost
<b>MAPAS</b>	Agency for Supervision of Fully Funded Pension Insurance
<b>MBI10</b>	Macedonian Stock Exchange Index
<b>MBDP</b>	Macedonian Bank for Development Promotion
<b>MEPSO</b>	Electricity Transmission System Operator of Macedonia
<b>MIA</b>	Macedonian Information Agency
<b>MIGA</b>	Multilateral Investment Guarantee Agency
<b>MNE</b>	Multinational Enterprise
<b>MSEC</b>	Macedonian Securities and Exchange Commission
<b>MW</b>	Mega Watt
<b>NCTS</b>	New Computerized Transit System
<b>NECC</b>	National Entrepreneurship and Competitiveness Council
<b>NEER</b>	Nominal Effective Exchange Rate
<b>NGA</b>	Next Generation Access Network
<b>NGN</b>	Next generation network
<b>NGO</b>	Non-governmental Organization
<b>NPAA</b>	National Programme for Adoption of the Acquis
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>OSCE</b>	Organization for Security and Co-operation in Europe
<b>PAR</b>	Public Administration Reform
<b>PDPL</b>	Programmatic Development Policy Loan
<b>PIFC</b>	Public internal financial control
<b>PISA</b>	Program for International Student Assessment
<b>PCL</b>	Precautionary Credit Line
<b>p.p.</b>	Percentage Point
<b>REER</b>	Real Effective Exchange Rate
<b>RESPA</b>	Regional School of Public Administration
<b>RIA</b>	Regulatory Impact Assessment
<b>ROAA</b>	Return on Average Assets
<b>ROAE</b>	Return On Average Equity
<b>SA 8000</b>	Global social accountability standard for decent working conditions
<b>SAA</b>	Stabilization and Association Agreement
<b>SEE</b>	Southeastern Europe
<b>SEETO</b>	South East European Transport Observatory
<b>SGHRM</b>	Steering Group on Human Resources and Mobility
<b>SLI</b>	State Labor Inspectorate



<b>SMEs</b>	Small and Medium-Sized Enterprises
<b>SRE</b>	Social responsibilities of enterprises
<b>TAIB</b>	Transition Assistance and Institution Building
<b>TARIC</b>	Tariff and Regulation of the Community
<b>TARIM</b>	Customs Tariff Database
<b>TIDZ</b>	Technological and Industrial Development Zones
<b>TIMSS</b>	Trends in International Mathematics and Science Study
<b>TFP</b>	Total Factor Productivity
<b>TTFSE</b>	Trade and Transport Facilitation in Southeast Europe
<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>UNDP</b>	United Nations Development Programme
<b>UNERR</b>	Unique National Electronic Registry of Regulations
<b>UNIDEM</b>	Universities for Democracy
<b>USAID</b>	United States Agency for International Development
<b>VAT</b>	Value Added Tax
<b>VET</b>	Vocational Education and Training
<b>VoIP</b>	Voice over Internet Protocol
<b>XBRL</b>	eXtensible Business Reporting Language



## Preface

Honorable,

Republic of Macedonia is under regular multilateral fiscal surveillance by the European Commission by submitting fiscal notifications and the Pre-Accession Economic Programme. Namely, by acquiring the status of a candidate country in 2005, Republic of Macedonia was also assigned the obligation to prepare and submit, on regular basis, medium-term Pre-Accession Economic Programme to the European Commission, which can be considered as a preparation of candidate countries for further coordination of economic policies as future EU Member States. Pre-Accession Economic Programme is predecessor of the Convergence Programmes which are being prepared by the Member States within the Stability and Growth Pact. By preparing the Programme, Republic of Macedonia prepares itself for gradual integration in the multilateral fiscal surveillance within the Economic and Monetary Union and the Europe 2020 Strategy.

Republic of Macedonia has prepared the fifth Pre-Accession Economic Programme 2011-2013, presenting medium-term macroeconomic and fiscal framework, as well as the agenda for structural reforms for the same period. This document is a joint result of the activities of several institutions, whereby the overall preparation is coordinated by the Ministry of Finance of the Republic of Macedonia. Preparation of the Pre-Accession Economic Programme, as coherent strategic document, is a verification of the capacity of the public administration from the point of view of coordination and efficient work.

Objective of the Programme is to present the activities of the Government of the Republic of Macedonia aimed at realizing the priorities arising from the Accession Partnership of the Republic of Macedonia with the EU, accelerating the economic growth of the country, to the end of reducing unemployment and improving the living standard of the citizens. The Programme presents recent macroeconomic developments, as well as medium-term expectations in the real, financial, external and monetary sectors, public finance, as well as public debt management, activities aimed at harmonizing the Macedonian legislation with the *Acquis Communautaire*, i.e. measures undertaken by the Government of the Republic of Macedonia towards preparing the economy to react correspondingly to the competitive forces upon acquiring the status of EU member state. It is important to point out that the Pre-Accession Economic Programme reflects the recommendations in the last Progress Report as regards further harmonization of the Macedonian legislation with the EU one.

In line with the Accession Partnership, strategic goals of the Government of the Republic of Macedonia for the period 2011 – 2013 continue to be the following: enhancing the attractiveness of the country for foreign and domestic investor and increasing the level of investments, improving education quality, rule of law, improving the quality of public services to citizens, increasing the capacity of the public administration in

implementing reforms, as well as prudent management of the public debt of the country on the medium run. Thereby, main priorities of the Government are the following: maintenance of macroeconomic stability and creation of predictable macroeconomic climate, reduction of unemployment, dynamic implementation of structural reforms and meeting Copenhagen criteria in the process of accession of the Republic of Macedonia in the EU.

In addition, key priority under the Accession Partnership is carrying out of obligations assumed under the Stabilisation and Association Agreement (SAA), which the Republic of Macedonia fulfills in full. In fact, Republic of Macedonia continues to meet all obligations envisaged in the first stage of Chapter 5 (Movement of workers, establishment, rendering services, capital) of SAA. Therefore, in October 2009, the European Commission proposed shifting to the second stage of the Association, in line with Article 5 of SAA. Full SAA implementation means full harmonisation of the national legislation with the *Acquis Communautaire*, as well as full functionality of the institutions.

Last Progress Report confirms that the Republic of Macedonia continues to meet the political criteria to a satisfactory level, while regarding the meeting of the economic criteria, it is concluded that the country continues to advance well. Hence, although the global crisis, the biggest in the last 80 years, has imposed new challenges, the Government of the Republic of Macedonia has managed to retain macroeconomic and social stability and to mitigate the consequences from the crises, to a great extent, on the citizens and the private sector. As a result of the sound macroeconomic policy of the country, the Macedonian economy achieved the third best result in Europe in 2009.

Receiving recommendation for membership by the European Commission second year in a row, as well as the achieved macroeconomic results in conditions of global economic and financial crisis, are result of the devoted work of the Government of the Republic of Macedonia and its ability to make wise decisions at moments calling for fast action. Still, one can always do better and more. Aware of future challenges, we go on.

In the period 2011-2013, we continue with dedicated work so to create functional, competitive market economy, capable of dealing with the challenges on the road to the European Union and minimising the adverse effects from the process of real convergence towards the European economy. The Government of the Republic of Macedonia will be fully committed to unconditionally maintain both macroeconomic and fiscal stability in the country, to further intensify economic growth and reduce unemployment, as well as to further develop knowledge-based society.

Yours respectfully,

**Zoran Stavreski MA**  
Vice Prime Minister  
and Minister of Finance



# PART I

## General Macroeconomic Framework and Objectives



Pre - Accession Economic Programme (hereinafter PEP) 2011 - 2013 is in line with many strategic documents adopted by the Government of the Republic of Macedonia, such as: National Programme for the Adoption of the Acquis, 2011 – 2013 Fiscal Strategy, 2010 – 2012 Public Debt Management Strategy, other strategic documents of the participating institutions, etc. The Programme focuses on the features of economic policy, represents the projections for the coming three - year period and explains the key structural reforms to be implemented so as to enhance the functioning of the market economy making it able of dealing with the competitive forces following the entry in the EU.

Previous Programme (2010 – 2012) was prepared in conditions of unfavorable external surrounding, which instigated adverse effects on the domestic economy as well, while the Government responded by adopting three anti-crisis packages and two Supplementary Budgets, thus managing to preserve macroeconomic stability and mitigate downward trends of GDP. Unlike last year, this Programme is prepared on the basis of macroeconomic indicators showing stabilization and slight recovery of the economy at the beginning of 2010, expectations for improvement of macroeconomic surrounding. Thus, the programme elaborates the policies of the Government, aimed at supporting the growth and faster exit of the country from recession. Thereby, it is expected that the economic growth will reach the levels prior to the crisis in 2013.

In order to lower the consequences from the global economic crisis on the Macedonian economy, the Government implemented countercyclical fiscal policy, as well as four anti-crisis packages. Such approach has contributed to preserving macroeconomic stability and only 0.9% decline of GDP. Effects from the economic crisis in the Republic of Macedonia in 2009 were with lower intensity compared to most of the countries in the region and the EU, where GDP decline was significant.

As a result of sound macroeconomic fundamentals and expected trends in the global economy, in particular the economy in the EU, as the most important trade partner to the Republic of Macedonia, economic growth in 2010 is expected to reach up to 2%, while in the period 2011 – 2013, economic activity in the Republic of Macedonia is expected to be in average up to 4.5%, approximately reaching the growth rates realized prior to the global economic crisis.

Objectives of the fiscal policy in the coming three-year period will remain focused on maintaining macroeconomic stability, supporting the Macedonian economy by improving the quality of public finance, mainly by intensifying capital investments aimed at improving infrastructure and physical capital, taking into account the foreign trade position and preserving stable Denar exchange rate. Thereby, budget deficit will be reasonable and non-distortive to the economy, within the Maastricht Criteria.

Main goal of the monetary policy for the period 2011 - 2013 remains to be maintenance of price stability. Thereby, in order for this goal to be achieved, Strategy of targeting nominal Denar exchange rate to the Euro will continue to be applied, aimed at realising

the most favorable macroeconomic climate for long - term sustainable economic development.

Current macroeconomic climate and external risks force to acceleration of the process of implementation of Copenhagen Criteria and the priorities under the Accession Partnership, in order to enhance competitiveness of the Macedonian economy. Hence, commitment of the Government of the Republic of Macedonia to implementing structural reforms will continue in the coming three-year period as well. Expectations are that their implementation will contribute to enhance the functioning of the market economy, by improving the business climate, improving the effectiveness of the services to citizens, further improvement of the property rights, cadastre reforms to improve records of property rights, strengthening the relations between the supply and the demand on the labor market, effective rule of law and execution of contracts, improving transport and energy infrastructure, supporting small- and medium-sized enterprises, strengthening fiscal capacity of municipalities, strengthening supervisory activities of regulatory bodies, strengthening productivity in agriculture and reducing the participation of the state in the private sector by rounding-up the privatization process.

PEP 2011 - 2013 comprises of three main parts. First part analyses the recent macroeconomic developments and medium-term macroeconomic scenario for the period 2011 - 2013, the second one presents policies for public finance management in the Republic of Macedonia, including analyses and medium-term projections of the Budget of the Republic of Macedonia and public debt management. This part also includes institutional features of public finance. The third part presents the process of implementing the reforms, fiscal implications there from, as well as the reform agenda for the coming three-year period.



## PART II

# Macroeconomic Developments



## 2.1. Economic outlook

### 2.1.1. Recent macroeconomic developments

**International economic climate.** Global slowdown of economic activity and expansion of global economic and financial crisis caused unfavorable developments in the developed countries, as well as in the emerging economies and developing countries.

World economy, following the growth of 2.8% in 2008, experienced contraction of the economic activity of -0.7% as a result of reduced investment activity and reduced global consumption. Reduced investment activity as well as the measures to protect domestic production implemented by the Governments worldwide, contributed to significant reduce of the volume of trade, which in 2009 dropped by 12,9%.

Global economic environment elevated spill - over effects on the EU economy, which resulted in an annual decline in Gross Domestic Product (GDP hereinafter) in 2009 of 4.2% Reduced consumption led to decline of inflation rate in the EU, thus its average level was 1% in 2009.

**Table 2.1.** International economic climate – selected macroeconomic indicators\*

	2008	2009	2010f**	2011f	2012f
<b>GDP</b>					
World	2.8	-0.7	4.5	3.9	4.0
EU	0.5	-4.2	1.8	1.7	2.0
USA	0.0	-2.7	2.7	2.1	3.0
Developing countries and emerging economies	5.7	2.6	6.8	6.1	6.1
<b>International trade growth</b>	4.8	-12.9	11.8	7.2	6.9
<b>Unemployment</b>					
EU	7.0	8.9	9.6	9.5	9.1
USA	5.8	9.3	9.6	9.4	9.0
<b>Inflation</b>					
EU	3.7	1.0	2.0	2.1	1.8
USA	3.8	-0.4	1.6	1.1	1.5
<b>Increase of oil price (US\$)</b>	98.5	62.0	79.9	88.9	90.8

Source: European Commission, European Economic Forecast - Autumn, November 2010 \*\*f- projections

\*European Economic Forecast – Autumn, November 2010 does not provide projections for the year of 2013.

However, certain improvement of macroeconomic indicators has been noticed in the second quarter in 2009, in particular as regards international trade and global industrial production. Improvement was, to a great extent, due to countercyclical fiscal policy, i.e. massive stimulative packages applied by many countries as of end-2008.





European Commission (hereinafter: EC) pointed out, in its Autumn European Economic Forecast dated November 2010, that global economy recovered in the first half of 2010 with a stronger dynamics than initially expected. Hence, EC projects global growth of 4.5% is projected in 2010, and 3.9% growth in 2011 (see Table 2.1.). However, it is a lower growth rate compared to performance of global GDP prior to the global economic crisis, and the result thereof was declined export, drop in prices of raw materials, metals and food, as well as decline in the level of direct investments. In its Autumn European Economic Forecast, EC projected recovery of world trade in 2010, with growth rate of 11.8%, being a significant improvement compared to 12.9% decline in 2009. However, labor market will feel the consequences from the global economic crisis in 2010 as well, so EC projected unemployment increase in EU of 9.6%, i.e. a deterioration of 0.7 p.p. compared to 2009. According to EC, increase in prices of oil (by 28.8% in 2010, in relation to the drop in 2009), as well as metals and raw materials will contribute to moderate increase of inflation and it is expected, at EU level, to be 2.0% in 2010, being an increase by 1 p.p. in relation to 2009.

**Recent economic trends in the Republic of Macedonia.** Global economic crisis, which caused the biggest contraction of the global economy in the last 80 years, inevitably led to decline in economic activity in the Republic of Macedonia as well. The crisis spilled over the Macedonian economy mainly through the external sector. In fact, contraction of global trade in 2009 led to drop in foreign demand for Macedonian export products, in particular in those branches that have highest share in the industrial production index. Hence, industry, as a sector being mostly export-oriented, felt the major consequences from the global crisis. Nevertheless, despite the fact that the spillover of the crisis caused the country, for the first time after 2001, to enter in a recession, economic performance shows that effects from the economic crisis in the Republic of Macedonia were with lower intensity compared to most of the countries in the region and the EU.

As a result, GDP decline of only 0.9% was registered, following the excellent performance of 6.1% and 5.0% in 2007 and 2008 respectively, which was mainly due to the sound macroeconomic fundamentals set before the crisis, as well as the four anti-crisis packages implemented by the Government of the Republic of Macedonia.

However, still vulnerable macroeconomic surrounding and low level of investment confidence, as a result of the effects from the crisis, caused for real GDP to decline by 1.1% in the first quarter in 2010, while signs of economy recovery were registered in the second and third quarter already, i.e. real GDP growth rate of 1.1% and 1.3% respectively. Hence, average growth in the first three quarters in 2010 is positive, amounting to 0.4%. Intensified upward trends are expected in the second half of the year.





**Table 2.2.** GDP growth rates (production and expenditure methods)

	2008	2009	2009				2010			
			I	II	III	IV	I	II	III	Average
<b>GDP</b>	5.0	-0.9	-0.8	-1.9	-2.2	1.2	-1.3	1.1	1.3	0.4
<b>GDP by production method</b>										
Agriculture	5.9	2.5	1.4	2.8	3.5	2.2	5.1	1.8	2.4	3.0
Industry	2.4	-8.5	-11.2	-10.5	-12.9	0.7	-1.3	1.8	0.7	0.4
Construction	-5.8	4.2	2.8	8.5	2.4	2.5	7.7	-12.1	18.4	3.4
Services	7	1.1	1.9	0.2	1.7	0.7	1.9	2.4	1.8	2.0
<b>GDP by expenditure method</b>										
Final consumption	8.0	-4.4	-3.4	-2.4	-4.6	-6.7	-0.4	-1.0	3.2	1.5
Personal	7.4	-3.9	-3.3	-2.6	-5.7	-3.9	-0.6	3.4	4.1	2.7
Public	10.8	-6.4	-3.8	-1.2	0.3	-18.1	-0.4	-7.7	0.4	-2.9
Gross capital formation	5.4	0.9	32.5	-14.2	-9.5	4.5	-47.3	4.7	4.8	-12.6
Export of goods and services	-6.3	-10.7	-15.9	-7.2	-7.3	-13.0	8.3	15.6	25.2	16.4
Import of goods and services	0.8	-11.1	-4.2	-11.4	-11.9	-16.0	-14.0	12.2	23.8	7.3

Source: State Statistical Office

Analyzing GDP from the expenditure side, in first three quarters of 2010, Final consumption increased in real terms by 1.5%. In that respect, growth of Final consumption was led by Personal consumption which increased by 2.7%, while Public consumption dropped by 2.9%. Gross capital formation dropped by 12.6%, mainly as a result of the large decline of 47.3% in the first quarter of 2010. Export of goods and services registered positive dynamics of growth during the first three quarters of the year, with real growth rate of 16.4%. Import of goods and services, following the decline in the first quarter, experienced positive growth rates in the following two quarters, thus amounting 7.3% for the analyzed period.

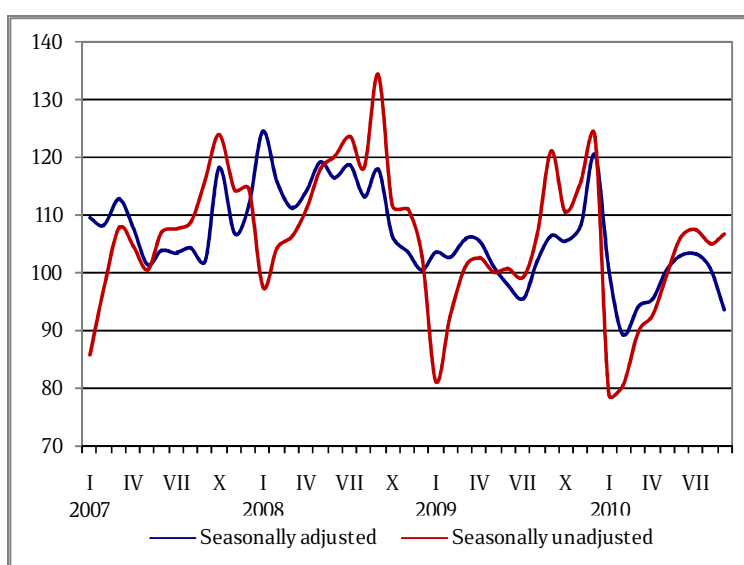


Analyzing GDP from the production side, Agriculture grew by 3% in the first three quarters of 2010, whereas the biggest increase was registered in the first quarter. Industry registered mild increase of 0.4% in the analyzed period. Following positive performance in the third quarter, the average growth rate of the Construction for the first three quarters of the year is 3.4%. However, expectations in the Construction are positive, taking into account the data on contracted construction works, which experienced high nominal growth of 32.1% in the period January-September in relation to the same period in 2009.

Industry, due to being significantly export oriented, felt mostly the consequences from the global economic crisis, i.e. the decline in external demand, which reflected the most on the production of metals and the metal industry. Thus, in 2009, industry experienced production decline of 7.7% compared to 2008. This resulted in decline of the share of industry in GDP creation as well. Positive contribution to industrial production growth in 2009, unlike 2008, was registered only by the Electricity, gas and water supply sector, which experienced an increase of 8.8%, thus limiting the decline of the industrial production. Manufacturing which accounts the most in the total index, declined by 9.3%, while the Mining and quarrying experienced the highest decline of 12.3%.

The index of industrial production in the first nine months in 2010 compared to the same period in 2009, dropped by 4.2% on cumulative basis. Thereby, Manufacturing, accounting for 83.9% in the structure of industrial production, declined by 7.8%. All branches with double-digit share within Manufacturing registered growth, as follows: Manufacturing of food products and beverages (3%), Manufacturing of wearing apparel (5.8%) and Manufacturing of basic metals (24.6%). Mining and quarrying experienced slight decline of 0.3%, while Electricity, gas and water supply sector registered growth of 21.4%. Branches that showed positive dynamics, participated with 63% in the industrial production index.

Chart 2.1. Industrial production index

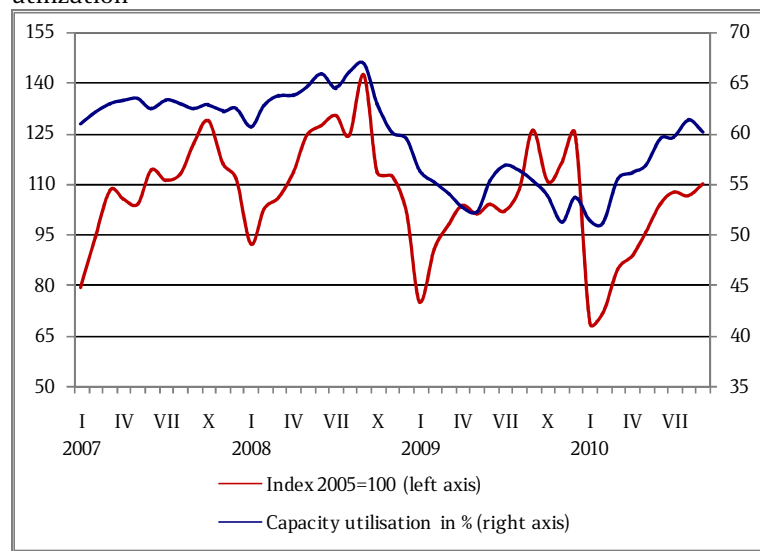


Source: State Statistical Office and calculation of Ministry of Finance



Developments in the Manufacturing sector are considered as relatively good indicator of overall trends in the economy, due to its importance and relation to other sectors in the

**Chart 2.2.** Processing production index and level of capacity utilization



Source: State Statistical Office and calculation of the Ministry of Finance

economy. Chart 2.2. shows the level of capacity utilization in the Manufacturing since 2007. As shown on the chart, when growth of overall economic activity started to slow down at the end of 2008, the industrial capacities utilization started to fall as well, thus reflecting the negative tendencies in Manufacturing. Nevertheless, upward trends and increase in the level of capacity utilization were registered at the beginning of 2010, having prospects to reach the pre-crisis level.

External sector was not immune to the global developments in 2009. In terms of high degree of trade integration, the significant decrease of both the cash foreign demand and metal prices on the international markets, led to significant drop of exports at the end of 2008. Taking into consideration the slower downward adjustment of imports, the trade deficit considerably widened in the first quarter of 2009. The global crisis also created negative expectations of economic agents, especially at the beginning of the year, which resulted in lower private transfers. These tendencies, together with lower capital inflows, caused significant deepening of the gap between the supply of and demand for foreign exchange in the first months of the year. In terms of fixed foreign exchange rate, the National Bank of the Republic of Macedonia (hereinafter: the National Bank) intervened on the foreign exchange market with net sale of foreign exchange, which reached 4.8% of GDP on cumulative basis.

The interventions on the foreign exchange market, together with the undertaken monetary measures and the credibility of the National Bank in maintenance of the foreign exchange rate stability, as well as the improved perceptions for the global economy, significantly stabilized the expectations. This was evident through the upward trend of private transfers, which began from the second quarter of 2009. Simultaneously, in the second quarter, continuous narrowing of the negative gap in the foreign trade was registered, in parallel to the downward adjustment of the domestic demand and the imports and narrowing of the negative energy balance. These developments, together with the increase in the capital inflows (partly as a result of the issued Eurobond by the Government on the international capital market), enabled continuous net purchase of foreign exchange in the second half of 2009. Until the end of the year, the level of the



gross foreign reserves augmented by 32.7%, ensuring coverage of average import of goods and services of 4.3 months of the following year. The deficit in the current account of 12.8% of GDP in 2008 reduced to 6.7% of GDP in 2009, as a result of the decrease in the trade deficit of 3 p.p. of GDP and higher net private transfers of 2.5 p.p. of GDP.

Within January - September 2010 period, the deficit on the current account equaled 0.5% of GDP<sup>1</sup>, which is a narrowing of 4.8 p.p. of GDP on an annual basis. The largest portion of the positive annual change is due to the favorable dynamics of the net inflows based on current transfers (positive contribution of 2.9 p.p. of GDP) and narrowed negative trade balance (contribution of 1.9 p.p. of GDP), and less to the improved balance in the trade of services (of 0.3 p.p. of GDP). In this analysis, the comparison base registered in the first quarter of 2009, when deepening of the trade deficit and decrease in the private transfers was registered, should be taken into consideration. During the analyzed period of 2010, the income was the only current account component that influenced towards broadening of the deficit, given the registered net outflow of 1.3% of GDP. In comparison with the same period of the previous year, the income balance worsened by approximately 0.2 p.p. of GDP and it is mostly due to the higher net outflow based on interest payments and smaller surplus on portfolio investments.

**Table 2.3.** Balance of payments' current account (in EUR millions)

	2005	2006	2007	2008	2009	I – IX 2010
<b>Current account, net</b>	<b>-122,5</b>	<b>-23,4</b>	<b>-421,2</b>	<b>-862,2</b>	<b>-449,3</b>	<b>-33,1</b>
<b>Trade balance</b>	<b>-858,5</b>	<b>-1,001.5</b>	<b>-1,181.0</b>	<b>-1,762.5</b>	<b>-1,551.0</b>	<b>-1,007.7</b>
- Exports f.o.b.	1,642.9	1,914.0	2,472.2	2,692.6	1,920.9	1,782.8
- Imports f.o.b.	-2,501.4	-2,915.5	-3,653.2	-4,455.1	-3,472.0	-2,790.5
<b>Sevices, net</b>	<b>-24,7</b>	<b>22,4</b>	<b>25,1</b>	<b>5,8</b>	<b>28,0</b>	<b>39,9</b>
<b>Income, net</b>	<b>-92,6</b>	<b>-26,1</b>	<b>-277,7</b>	<b>-90,9</b>	<b>-58,5</b>	<b>-92,2</b>
<b>Current transfers, net</b>	<b>853,3</b>	<b>981,9</b>	<b>1,012.4</b>	<b>985,5</b>	<b>1,132.3</b>	<b>1,026.8</b>
- Official, net	53,4	58,8	24,3	49,4	35,5	25,4
- Private, net	799,9	923,1	988,2	936,1	1.096,8	1.001,4

Source: National Bank of the Republic of Macedonia

Within the January - September 2010 period, the negative balance in the foreign trade of goods equaled 16% of GDP, which is lower than the deficit registered in the same period of 2009 by 1.8 p.p. of GDP. The annual narrowing of the trade deficit resulted from the more intensive growth in the export of goods of 25.2%, compared to the import of goods of 11.1%. The higher export of goods is a result of the gradual recovery of the effective foreign demand and improved conjuncture of the metal prices on the international markets. The positive change is primarily due to the enhanced export of iron and steel

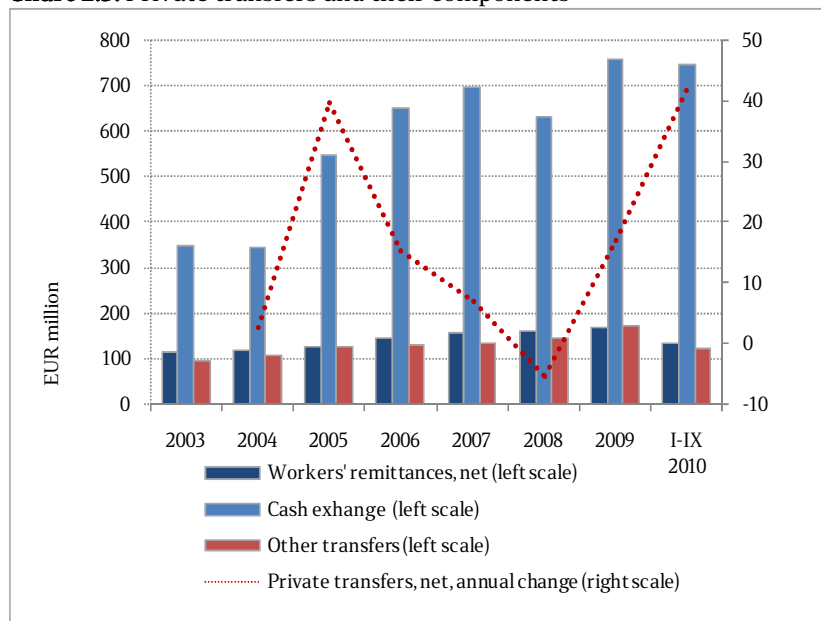
<sup>1</sup> GDP according to the October projection of the National Bank.

(contribution of 40.5%), then the export of chemical products (contribution of 24.1%), and the export of metal ore and energy (with a contribution of 15.1% and 11.3%, respectively).

Analyzing the imports, during the first nine months of 2010, the following sub-periods can be emphasized: first quarter of the year when the high comparison base and the decrease in the domestic demand influenced towards annual fall in the imports and the April - September period, when annual growth rates in the imports were registered, partially conditioned by the recovery of the economic activity. Regarding the imported goods, intensified import was registered with oil and oil derivatives (contribution of 26.4%), followed by vehicles<sup>2</sup> (25.9%), non-organic chemical products (25.5%), as well as the import of the categories iron, steal and metal ore (16.2% and 15.7%, respectively).

The real effective exchange rate (REER: hereinafter) based on the consumer prices, as an indicator for the price competitiveness, in the January - September 2010 period registered depreciation of 3.0% relative to the same period of 2009, which is mostly due to the favorable price ratio and less to the depreciation of nominal effective exchange rate (NEER: hereinafter) of 0.8%. On the other hand, during the same period, REER based on the prices of the producers of industrial products appreciated by 0.9% on an annual basis, which is primarily due to the unfavorable price index.

**Chart 2.3.** Private transfers and their components



Source: National bank of the Republic of Macedonia

The analysis of the total foreign trade, from the aspect of the most significant trading partners shows that the EU is our most important trading partner, with a share in the total foreign trade of 55.9%. The structural share of EU in the trade is higher by 2.2 p.p. compared to the same period of the previous year. Within EU, it is mostly traded with Germany, Greece, Bulgaria and Italy. It should be

emphasized that in the first nine months of 2010 the trade deficit with EU decreased by 24.2%, opposite to its widening in 2009 by 37.8%, as a result of the global economic crisis and the reduced demand for iron and steel. That points to intensification of the external

<sup>2</sup> The amendments introduced in March 2010 enabled reduction of the excise rates on motor vehicles and the customs duties in the import of used motor vehicles, with the effectiveness of these provisions pertaining to the import of older vehicles being valid until September.



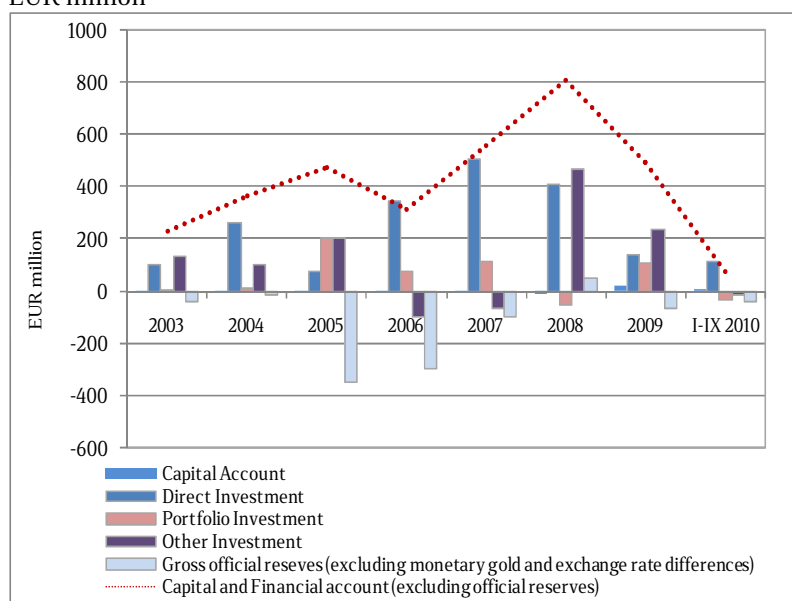
demand in 2010 and gradual return of the Macedonian exporters on the international markets.

The favorable dynamics of the private transfers, which began in the second quarter of the previous year, continued also in 2010, in conditions of stabilized expectations of the domestic agents. Namely, in the first nine months of 2010, the private transfers augmented by 29.6%, reaching 14.3% of GDP. Within the private transfers, the net inflows on the currency exchange market dominate with 74.3% and are higher by 42%, relative to the same period of 2009.

Since the beginning of the year until September 2010, cumulatively, the net inflows on the capital and financial account (without the official reserves) equaled 1% of GDP. The largest portion of the capital net inflows in the Macedonian economy during the respective period, arises from foreign direct investments (hereinafter: FDI) in the amount of 1.6% of GDP and through external net debiting of 1.4% of GDP. As a contrast, capital net outflows were registered at the currency and deposits position, trade credits and portfolio investments (of 1.4%, 0.7% and 0.5% of GDP, respectively). Analyzed on an annual basis, the total amount of the net inflows in the first nine months of 2010 is lower by 80.1%, representing a continuity of the movements from the previous year. Concerning this analysis, the comparison base should be taken into consideration, i.e. the inflows from the issuance of the Eurobond by the Government in July 2009, as well as the withdrawal of the IMF quota in August 2009. If excluded, it is a 40% decrease, which points to still present restraint of the foreign investors in 2010 as well.

In the analyzed period, net inflows of EUR 110.3 million through the FDI were realized, which is less by 20% compared to the same period of 2009. In the structure of the FDIs, net inflows were realized on the basis of all subcategories, the largest portion being generated on the basis of the shareholders' capital and intercompany debt. The share of the inflows based on shareholders' capital and intercompany debt is smaller relative to the previous year by 63.7% and 53.3%, respectively. Such a structure reflects the global environment, which still characterizes with more pronounced liquidity needs and restraint from new

**Chart 2.4.** Capital and financial account and its main components, in EUR million



\* "-" at the gross reserves means accumulation

Source: National Bank of the Republic of Macedonia

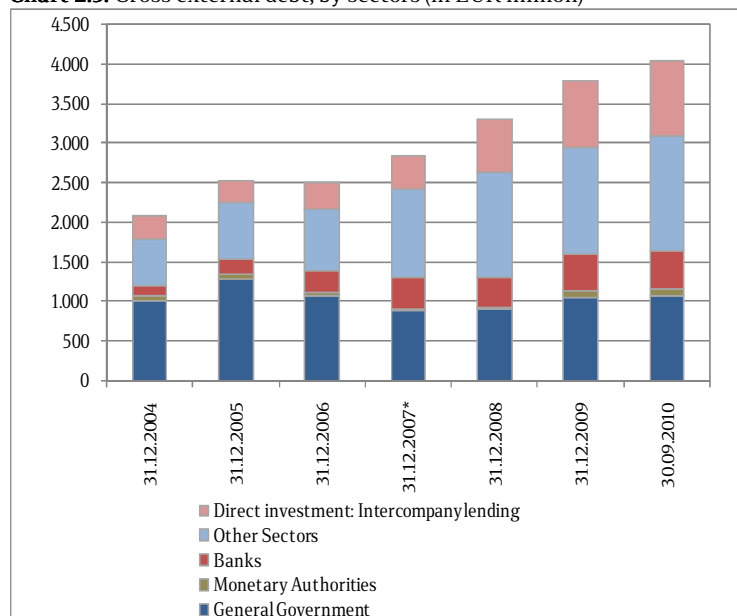


investments. With the portfolio investments category, net outflows in the amount of EUR 33.4 million were registered, with almost half of them referring to the residents' purchase (mainly pension funds) of debt securities of the country issued abroad.

In conformity with the movements in the balance of payments as of September 2010 inclusive, the gross foreign reserves amount EUR 1,689.3 million, registering rise of 5.8% relative to the end of 2009, maintaining the level of 4.3 months coverage of import of goods and services from the following year.

The gross external debt reached EUR 4,030.1 million on September 30<sup>th</sup> 2010, which is rise of 6.6% compared to December 31<sup>st</sup> 2009. The increase in the external debt is mostly due to the loans amongst connected entities (42.2%), external debts of the other sectors of the economy (contribution of 36.3%) and banking sector debts (12.5%). The increase in the indebtedness amongst connected entities (the intercompanies' debt) refers to the increase of the short and long term liabilities towards foreign investors, while the increased debt of the other sectors reflects the increase in the short-term commercial credits (trade credits), arrears of the corporate sector and short-term loans. The level of the external indebtedness of the country registered reached 57.7% of GDP at the end of September 2010. However, the level of external indebtedness remains among the lower ones in the region.

**Chart 2.5.** Gross external debt, by sectors (in EUR million)



Source: National Bank of the Republic of Macedonia

With the latest revision of the projection of the Balance of Payments<sup>3</sup>, the deficit on the current account in 2010 is expected to equal 3 - 4% of GDP, which is improvement relative to 2009. The narrowing of the current account deficit is expected to be triggered by the contraction of the trade deficit and the widening of the surplus with the private transfers. Namely, the private transfers are estimated to reach level between 18 - 19.5% of GDP in 2010, opposite to 16% of GDP in 2009, reflecting the already realized inflows, despite the slower dynamics expected for the second half of the year and in line with their common conservative projections' approach and the assumed gradual normalization of these inflows.

<sup>3</sup> According to the October projection of the National Bank.



The negative trade balance in 2010 is expected to equal approximately 21.6% of GDP, which is narrowing of around 1.4 p.p. of GDP on an annual basis, given the decrease in the non-energy balance from 16.8% to 14.4% of GDP. This mainly arises from the improved balance in the trade of iron and steel (given the better external demand and higher prices of these products), larger export of ore and chemical products. The gross foreign reserves, as a key variable of the monetary policy, are expected to retain the adequate level and to ensure about four-month coverage of the imports in the following year.

**Labor market.** Despite the economic crisis that spread over the Republic of Macedonia, positive developments were registered on the labor market in 2009. Namely, according to the data in the Labor Force Survey, employment rate in 2009 surged to 38.4% (see table 2.4.), being an increase of 1.1 p.p. compared to 2008. Unemployment rate in 2009 was the lowest since 2003, amounting 32.2%, which was a decline by 1.6 p.p. compared to 2008. During the same period, number of unemployed dropped by 11,536 persons, being a decline of 3.7%. Thereby, in terms of economic crisis, in 2009, the Republic of Macedonia was the only country in the region registering decline in the unemployment rate. Reduction of unemployment rate is partially explained with the reduction of grey economy, i.e. inclusion in the system of workers who worked so far, but were not registered.

**Table 2.4.** Labor market developments

	2008	2009	2009				2010		
			I	II	III	IV	I	II	III
Working-age population	1,633,341	1,638,869	1,634,986	1,637,828	1,640,302	1,642,360	1,644,423	1,648,132	1,649,507
Activity rate	56.3	56.7	56.2	57.0	57.3	56.1	56.3	56.0	57.6
Labor force	919,424	928,775	919,026	933,878	940,661	921,534	925,613	923,323	949,313
Employed	609,015	629,901	618,189	636,156	642,541	622,720	615,962	627,129	648,773
Unemployed	310,409	298,873	300,837	297,722	298,120	298,814	309,651	296,194	300,540
Employment rate	37.3	38.4	37.8	38.8	39.2	37.9	37.5	38.1	39.3
Unemployment rate	33.8	32.2	32.7	31.9	31.7	32.4	33.5	32.1	31.7
Young population	56.4	55.1	54.4	54.9	54.6	56.6	57.1	55.0	51.9
Women	34.2	32.8	34.5	32.6	32.1	32.1	33.5	33.2	31.0
<b>Employed by sectors</b>									
Agriculture	119,749	116,668	120,186	122,956	119,474	104,055	109,821	121,442	128,825
Industry	151,149	146,328	143,014	146,818	146,631	148,849	143,047	141,803	143,650
Construction	39,381	40,749	38,553	41,615	42,608	40,220	39,515	41,504	42,427
Services	298,737	325,407	316,437	321,765	333,830	329,594	323,579	322,379	333,872
<b>Employed by type of ownership</b>									
Public	108,857	115,086	112,115	115,377	116,368	116,483	120,566	121,747	119,469
Private	500,159	514,816	506,074	520,779	526,173	506,237	495,396	505,382	529,304

Source: State Statistical Office





In the first nine months of 2010, labor market registered positive dynamics. According to the latest available data for the Q3 of 2010, activity rate reached 57.6% being an increase of 0.9 p.p. when compared to the 2009 average. Employment rate in the analyzed period increased to 39.3% being an increase of 0.9 p.p. The unemployment rate in the Q3 of 2010 amounts 31.7%, being an improvement of 0.5 p.p. compared to the 2009 average. The number of employed persons in the third quarter of 2010 increased by 2.9% when compared to the average level of 2009, while the number of unemployed persons noted slight increase of 0.5%.

In 2009, the nominal average net and gross wages registered an annual growth of 9.8% and 0.6%, respectively. The annual growth reflects the increase in the wages of both the public and private sector. The mild price decrease during 2009 resulted in higher real annual growth of average wages, compared to the nominal ones (growth of 10.6% and 1.4% in the corrected net and gross wage, respectively), reflecting the increase in the real purchasing power of the economic agents<sup>4</sup>.

Average net wage in the first nine months of 2010 was higher by 2.8% in nominal terms compared to the same period in 2009. Average gross wage for the analyzed period is higher by 0.8%. In the first nine months of 2010, moderate inflation rate caused lower increase of net wage of 1.7% and a decrease of 0.3% of gross wage in real terms. Projections for the average nominal increase of net and gross wage by 2.8% and 0.8% respectively is expected to be realized by the end of 2010.

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<sup>4</sup> The calculations of the Ministry of Finance exclude the effect of the inclusion of the board and transport allowances in the income tax base.

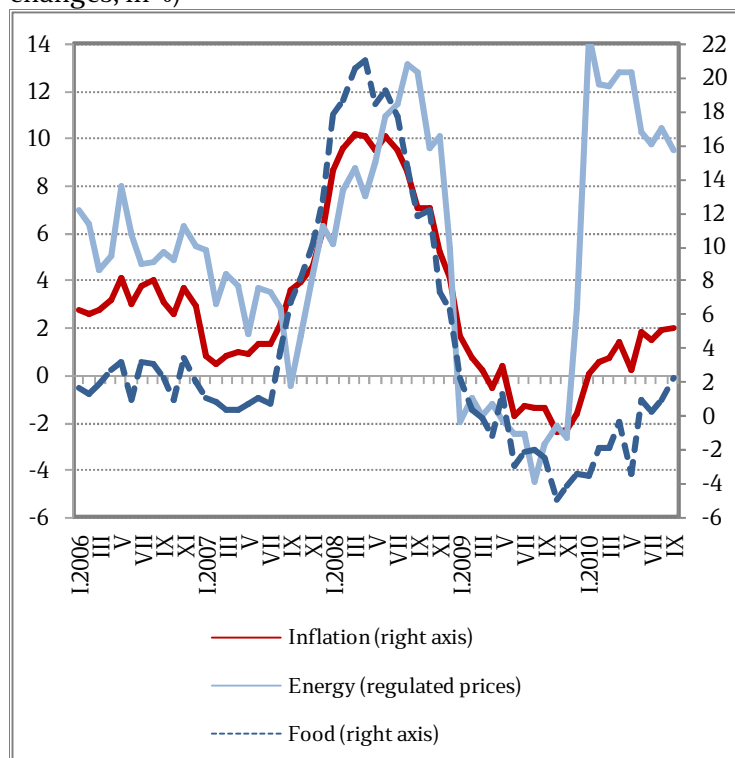


**Inflation.** The global recession terminated the 2008 price boom phenomenon, led by the food and energy prices, causing significant decrease in the inflation rates in 2009 at global level. In the Republic of Macedonia, after high average inflation of 8.3% in 2008, the consumer prices decreased by 0.8% in 2009. The decrease in general price level was mostly driven by those categories that registered largest increase in the preceding year - food and oil derivatives. These categories had negative contribution of 0.7 and 0.9 p.p. respectively, which was partly neutralized by the higher prices of electricity (at the end of the previous year), which positive contribution equaled 0.6 p.p.

Following the negative inflation rates of 2009, the inflation in 2010 remained low and stable. The average inflation rate, in the first nine months of 2010, equaled 1.1%, which is mainly due to the increase in electricity prices at the beginning of the year and the increase in central heating prices in January and August (with a total contribution of 0.8 p.p.), as well as to the higher prices of oil derivatives on annual basis (a contribution of 0.6 p.p.). Observed on an annual basis, the inflation equaled 2.0% in September, which is due to the higher positive contribution of food prices. The core inflation, which excludes food and energy, maintained on a stable level in 2010, approximately around zero.

The average annual inflation for 2010 is expected to be around 1.5 - 2%. However, the inflation risks register upward direction until the end of 2010. The risks mainly arise from the possible inflationary pressure by food prices related to the low yield of agricultural products (mostly wheat) in global terms as well as from the movements of world prices of energy sources, which can trigger higher import prices. Additional source of upward risks are the possible pass-through effects of the regulatory prices increase to the prices of other products and services. On the other hand, taking into consideration the developments in the real sector of the economy, no significant inflationary pressures on the demand side are expected by the end of 2010.

**Chart 2.6.** Inflation and energy and food prices (annual changes, in %)



Source: State Statistical Office and calculations by the National Bank of the Republic of Macedonia



*Monetary policy.* The monetary policy in 2009 was conducted in conditions of more pronounced risks and uncertainties regarding to the intensity of the transmission effects of the global financial and economic crisis on the domestic economy. The depreciation pressures on the domestic currency in the first half of the year were one of the initial crisis effects, when in circumstances of mounting trade deficit and negative expectations of the domestic entities, the demand for foreign exchange constantly exceeded the supply. In such conditions, given the fixed foreign exchange rate, the National Bank intervened on the foreign exchange market with net sale of foreign exchange in the first five months of the year. Additionally, the National Bank responded to the pressures on the foreign exchange market by gradual tightening of the monetary policy, so the basic interest rate in March reached 9%. In May, a Decision on increasing the reserve requirement allocation rate of banks' foreign currency liabilities (from 10% to 13%) and liabilities with FX clause (from 10% to 20%) was adopted.

The undertaken monetary measures, as well as the better and less uncertain forecasts about the world economy from the beginning of the second half of the year, contributed to significant stabilization of expectations and recovery of economic agents' confidence. This, together with the favorable trends in the external sector enabled change in the developments on the foreign exchange market, hence the National Bank intervened with net purchase of foreign exchange from June until the end of 2009. Such positive changes, together with the stable external position expected in the following period, created room for relaxation of monetary policy, and consequently in November 2009 the National Bank lowered the basic interest rate.

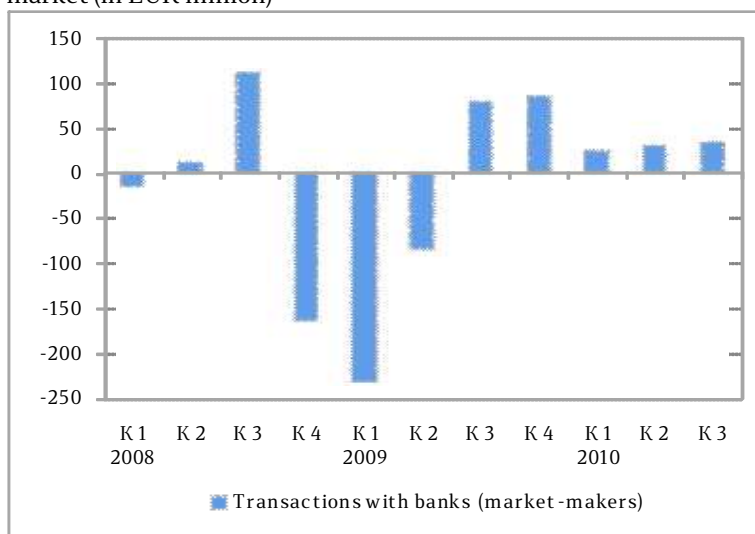
In 2009, the banking sector remained stable, registering high level of confidence. The low degree of domestic banks' exposure to foreign sources of financing, prevented occurrence of larger distortions. The measures that the National Bank undertook with the first crisis' tide, obliging banks to maintain certain minimal level of liquid assets and enabling them to reduce credit risk through investments in foreign currency deposits with the National Bank by enacting a Decision on the foreign currency deposit with the National Bank contributed to such circumstances.

The developments in the real and external sector at the beginning of 2009 contributed to slowing down monetary growth, in terms of reduced domestic currency savings in the first months of 2009. The positive changes registered in the second half of 2009 accelerated the growth of banks' deposit potential, so the total deposits in 2009 registered an increase of 7.1% compared to the increase of 12.4% in the previous year. The banks activity on the credit market decelerated considerably, reducing the credit growth from above 30% in 2008 to 3.5% in 2009. Such adjustments on the credit market were triggered by the worsened expectations of the banks, reduced sources of financing, as well as smaller demand for credits. In 2009, the banks' interest rate policy was directed towards savings stimulation, while tightening the crediting terms.



The macroeconomic environment for implementation of the monetary policy in the first three quarters of 2010 was relatively favorable. The positive trends on the foreign exchange market, which began in the second half of the previous year, continued also in the first nine months of 2010, reflecting the stabilized expectations of economic agents, higher private transfers and reduced import demand. Such movements, together with more favorable expectations for the external sector, given negative production gap and absence of inflationary pressures, created a room for further relaxation of the monetary

**Chart 2.7.** National Bank interventions on the foreign exchange market (in EUR million)



Source: National Bank of the Republic of Macedonia

policy. In 2010, the gradual decrease in the basic interest rate continued. Thus, from the level of 9% at the end of November 2009, the interest rate of the National Bank reduced to 4.5% in September 2010.

In September 2010, the reserve money<sup>5</sup> registered annual increase of 9.5%. On cumulative basis, within the January - September 2010 period, the foreign exchange

transactions of the National Bank were the main flow of reserve money creation, given realized net purchase of foreign exchange of about 1.3% of GDP. On the other hand, the CB bills and the Government's Denar deposits, acted towards reserve money withdrawal. The higher level of CB bills by 68% as of September, as well as the banks' interest on the Treasury bills auctions, points to still present conservative behavior of the domestic banks, proving the crucial role of safety and stability in their investment decisions.

The gradual stabilization of both, the macroeconomic environment and the expectations of domestic agents, as well as the favorable trends in the external sector, resulted in acceleration of the positive developments of deposits in the banking system, initiated in the last quarter of 2009. In September 2010, the annual growth rate of total banks' deposits equaled 14.5%, compared to the annual drop of 0.3% in September 2009. In terms of stable expectations of domestic agents and stimulating yields on Denar instruments, in the first nine months of 2010, Denar deposits continued to grow, following a trend initiated in the last quarter of 2009. Namely, after the decrease in annual growth rates in the previous two years as a reaction to the external shocks, in the first nine months of

<sup>5</sup> It includes currency in circulation (including also the cash in the banks' vault), reserve requirement in Denars and in foreign currency and the excess of liquid assets over the reserve requirement (in Denars). Without the reserve requirement, in September 2010, the reserve money registered annual increase of 9.7%.

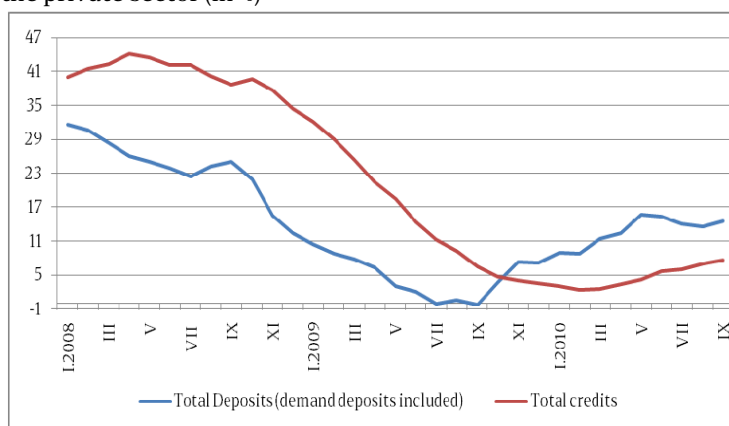


2010, the Denar deposits registered an increase and in September, they surged by 21% annually, thus contributing to the deposit potential growth by 65.9%. Simultaneously, the annual growth rate of the foreign currency deposits equaled 9%. During the first nine months of 2010, the average share of foreign currency deposits in the total deposit potential is similar to the level evidenced in 2009, which is about 53% (compared to the average share of 47% in 2007 - 2008). In comparison with end of 2009, slight decrease in the share of foreign currency deposits of 1.6 p.p. was registered, showing that the agents need longer period to change their currency preferences. Regarding the sectoral structure, in September 2010 the households' deposits registered annual growth rate of 17.6%. The deposits of the private enterprises<sup>6</sup> registered annual increase of 6.8%, opposite to the same period in the previous year, when enterprises' deposits caused the annual decrease in the banks' deposit potential.

Positive signals for stabilization of the global economic flows, savings growth, enhanced confidence and improved expectations in the domestic economy, coordination of monetary and fiscal policy, monetary policy relaxation, had positive transmission effects on the banks' credit activity. In September 2010, the annual growth rate of total credits equaled 7.7%,

with more intensified credit growth being registered since the second quarter. With respect to the intensified growth in the deposits relative to the credits, the trend of the credits/deposits ratio is downward and in September it equals 92.6%. Regarding the currency structure, Denar loans (which went up by 5.5% on annual basis) had more significant contribution (of 55.6%) to the annual growth of total credits in September 2010. The annual growth rate of the foreign currency credits equaled 15.8% in September. Analyzed by sectors, in September the households and enterprises' credits registered annual increase of 4.3% and 10.2%, respectively. The new crediting of the corporate sector in the first nine months of 2010 is twice bigger than the total amount of credits placed in 2009. The intensified crediting of the banks in this sector follows the trend registered in the second half of the previous year. On the other hand, in the second half of 2009, the lending to households stagnated, while in the first nine months of 2010, it showed an upward trend. The banks' crediting of the private sector until the end of 2010 is expected to increase further and to record a growth rate of about 9%. The credit growth is expected to continue in the following three years with moderate pace.

**Chart 2.8.** Annual growth rates of the total deposits and credits to the private sector (in %)



Source: National Bank of the Republic of Macedonia

<sup>6</sup> In September, the total enterprises' deposits (private and public) augmented by 5.4%, annually.





The changes in monetary and fiscal policy towards decreasing the basic interest rate of the CB bills and the interest rate of the government securities respectively, had an adequate reflection on the interest rates in the banking sector, which registered fall in the first nine months of the year. This decrease was caused also by the banks' better risk perception and expectations, smaller financial constraints, as well as by certain legal provisions that set mechanisms for restricting the maximum contractual interest rate. The moderate downward adjustment is in favor of the gradual facilitation of credits accessibility and credit market recovery. The interest rate on the total Denar loans of 10.3% in December 2009, went down to 9.2% in September 2010. Changes in the same direction were registered also with the deposit interest rate on Denar deposits, which reduced from 7.5% in December 2009, to 6.8% in September 2010. The larger decrease in the lending interest rate resulted in contraction of the interest rate spread, which reduced to 2.4 p.p. in September 2010. In September, the weighted interest rate on the foreign currency credits and foreign currency deposits equaled 7.4% and 3%, respectively (compared to 7.6% and 3.4%, respectively at the end of 2009).

## 2.1.2. Recent developments in the financial system

**Banking Sector.** As of September 2010, the banking system of the Republic of Macedonia comprises of 18 banks and 9 savings houses. Compared to the end of 2009, the number of banks remained unchanged, while the number of the savings houses reduced by one. The banks remained dominant in the banking system, opposite to the insignificant role of the savings houses in the overall activities of the banking system (their share in the total credits, total deposits and in the total assets of the banking system remains below 2% in each of these categories).

Foreign capital remains dominant in the total shareholders' capital. The number of banks in dominant foreign ownership (14 banks), as well as the number of subsidiaries of foreign banks (8), remained unchanged. The banks in dominant ownership of foreign shareholders preserved their dominant position on the market (the share of these banks in the total assets, credits, deposits, capital and income is above than 85%). Regarding the dominant owners' domicile country, the largest portion of the assets of the banking system is concentrated with the banks in dominant ownership of shareholders coming from the EU member states. The banks with state capital participate in the total assets of the banking system with a share just below 2%.

The level of financial intermediation of the banking system at the end of June 2010, measured by the share of total assets, the credits and deposits in GDP equaled 68.3%, 43.7% and 48.6% respectively (at the end of 2009, these rates equaled 65.0%, 42.0% and 45.5% of GDP, respectively). The group of large banks has dominant position in the financial intermediation.



The total assets of the banking system in 2010 continued to register more intensive growth relative to 2009. Thus, on 30<sup>th</sup> of September 2010, the total assets equaled Denar 287,8 billion, while the annual growth rate equaled 12% (1.5% in September 2009).

The deposits of the non-financial entities are the main driving force for the assets growth. On September 30<sup>th</sup>, 2010, the deposits of the non-financial entities equaled Denar 202,2 billion. As of September 30<sup>th</sup>, 2010, the annual growth rate of the deposits equaled 9.8% (0.3% in September 2009). In 2010, the conversion of the deposits into foreign currency ceased and Denar deposits began to mount. The annual growth rate of Denar deposits equaled 26.9% (as of the third quarter of the preceding year, the Denar deposits registered a decrease of 14.8%), while the annual growth rate of the foreign currency deposits equaled 3.7% (in September 2009, the annual growth rate of the foreign currency deposits equaled 23.7%). Regarding the sectoral structure, the households' deposits still dominate (with about 2/3 of the total deposits). The annual growth rate of the households' deposits equaled 17.8% and their rise determined the annual increase in the total deposits. Opposite to the previous negative growth rate of enterprises' deposits, as of September 2010, they registered an annual growth of 3.6%.

The loans extended to non-financial entities are dominant category in the assets of the banking system. The annual growth rate of the total loans as of September 2010 equaled 7.3% (annual growth rates on the credits in September 2008 and September 2009 equaled 38.5% and 6.1%, respectively). The trend of deterioration of the credit portfolio is still present. The share of the non-performing loans in the total loans reached 10.6% (10.1% on June 30, 2010). However, according to some indicators, the trend of worsening of the credit portfolio quality ceased. Thus, the share of the exposure classified in the risk categories C, D and E in the total exposure and the average riskiness of the credit portfolio of the banks, for one-year period increased by only 0.1 p.p. and on September 30<sup>th</sup>, 2010, they equaled 8.3% and 6.8%, respectively. The indirect credit risk arising from the transmission of the interest rate risk and currency risk from the banks to their client (by using safeguard clauses in the loans agreements) becomes extremely important for the banks' risk profile.

Since the second half of 2009, the liquidity of the banking system improved. The prudent regulatory measures undertaken by the National Bank had large contribution to the qualitative strengthening of the banks' liquidity position<sup>7</sup>. Since the implementation of this measure, the banks' liquid assets registered an upward trend and on September 30<sup>th</sup>, 2010, they equaled 27.6% of the total assets (4.3 p.p. more compared to September 2009). The level of coverage of the households' deposits with liquid assets equaled 56%, which is higher by 5.8 p.p. compared to September 2009. The deposits are the dominant source of financing of the bank activities, which was one of the reasons for stability maintenance

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<sup>7</sup> Pursuant to the Decision on managing the banks' liquidity risk ("Official Gazette of the Republic of Macedonia" no. 163/08, 66/09 and 144/09), since March 2009, according to the prescribed dynamics, the liquidity ratio of the assets and liabilities in Denars and in foreign exchange with maturity of 30 and 180 days, with the banks should equal 1.

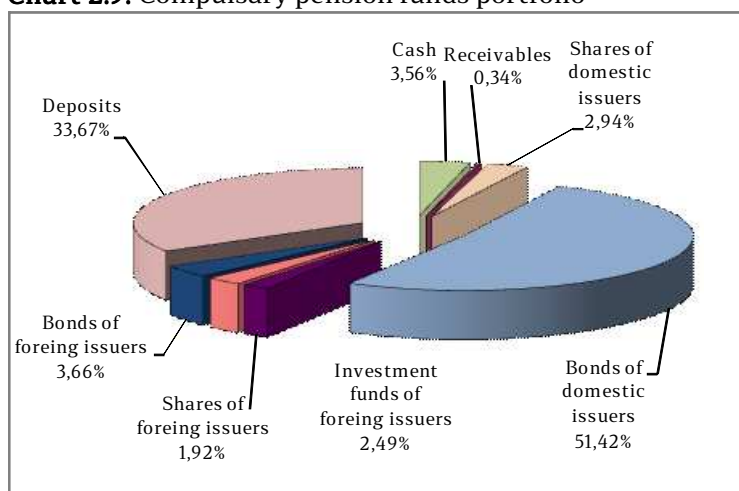
of the banking system during the global economic crisis. The presence of the interest rate risk and the currency risk is minor.

In the first nine months of 2010, the total gain of the banking system equaled Denar 948 million. It is less by 30% relative to September 2009. ROAA and ROAE equaled 0.5% and 4%, respectively (compared to September 2009 when ROAA and ROAE equaled 0.7% and 6%, respectively).

The banks maintained relatively high solvency position. On September 30<sup>th</sup>, 2010, the capital adequacy ratio at the level of the banking system equaled 16.4% (twice more than legally prescribed minimum of 8%). 'Tier 1' rate equals 13.7%. According to the stress test simulations conducted by the National Bank, the banking system and individual banks show satisfactory resistance to the influence of the hypothetical shocks.

**Sector for Fully Funded Pension insurance.** As of September 30<sup>th</sup>, 2010 the number of second pillar members is 257.027 out of which 68.349 or 26% are voluntary members and 189.678 or 74% are mandatory members.<sup>8</sup> As of January 2006, the payment of the contributions in the second pillar has begun with 65% of the contributions for the two-pillar members are being paid in the first pillar, while 35% of the contributions in the second pillar. As of September 30<sup>th</sup>, 2010 net assets of the second pillar are around Denar 11 billion (EUR 184 millions), which is an increase by 49% compared to the level of assets in September 2009. The available data on September 30<sup>th</sup>, 2010 show that around 8% of the mandatory pension fund assets are invested abroad and 92% are invested in domestic financial instruments.

**Chart 2.9.** Compulsory pension funds portfolio



Source: Agency for supervision of fully-funded pension insurance

The functioning of the third pillar (Fully Funded Pension Insurance) has begun in the second half of 2009 when both of the existing Pension Companies obtained licenses to manage voluntary pension funds. As of September 30<sup>th</sup> 2010, the third pillar counts 4.758 members, out of which 41% are individual members, while 59% are participants in the

<sup>8</sup> From the second half of 2005 has started the functioning the second pillar (Mandatory Fully Funded Pension Insurance). The participation in the second pillar is mandatory for all employed after January 2003 and for the employed before that period the system is voluntary and they had possibility to enter in it until 31<sup>st</sup> of December 2005.



professional pension schemes. The assets of the voluntary pension funds amount around Denar 29 million, on September 30<sup>th</sup>, 2010.

The development of the second and the third pillar of the fully funded pension insurance reinforce the pension system of the country through diversification of pension sources thus, providing an opportunity for legal entities from the EU member - states to enter this system as pension companies and other legal entities. The development of the second and third pillar also allows pension fund assets to be invested in securities issued and guaranteed by the EU member - states.

**Insurance Sector.** The main characteristic of the insurance sector in the Republic of Macedonia is its small share of 4.5% of the total asset in the overall financial system which is largely a result of the domination of the banking system. The level of density at the end of 2009 amounted EUR 51, as opposed to the average of EUR 89 in the SEE countries. The penetration rate was 1.6%, compared to the average rate of 2.1% in the SEE countries. Taking into consideration the value of this indicator, the insurance sector in the Republic of Macedonia is almost at the same level as those in Serbia, Romania, and Turkey. The small number of companies offering life insurance, low level of knowledge about the insurance products and services, as well as the low living standard of the population are among the factors contributing to the low penetration rate of life insurance amounting merely 0.1% of GDP.

As of September 30<sup>th</sup> 2010, 13 insurance companies, 14 insurance brokers and 6 insurance agencies are active on the insurance market. The Insurance Supervision Agency expects that 2 new insurance companies will obtain license for providing life insurance. It seems significant to note that the insurance companies are in dominant ownership of foreign investors, with twelve insurance companies are owned by foreign legal entities and one insurance company is fully owned by domestic shareholders. Foreign investors own 81% of the total capital.

General insurance is a dominant category within the gross premium, amounting 95.5%. Regarding the structure of the premiums, mandatory insurance of motor vehicles continues to dominate with 45.5%, followed by insurance of property against fire and other calamities (13.1%), as well as full coverage insurance of vehicles (13.9%). The other categories have a share lower than 10%. It needs to be noted here that a constant decrease of the share of this type of mandatory insurance has been observed over the past three years, which leaves space for a wider offer of other insurance products and services as well.



**Table 2.5.** Gross Premium and Structure

	2005	2006	2007	2008	2009
Gross Written Premium (million mkd)	5,105	5,445	6,109	6,421	6,183
<b>Premium Structure</b>					
Non-Life	97.86%	97.89%	97.20%	95.86%	95.53%
Life	2.14%	2.13%	2.80%	4.16%	4.47%

*Source:* Insurance Supervision Agency

As of September 30<sup>th</sup> 2010, the gross written premium of general insurance (including re-insurance) amounts Denar 4.474 million and in comparison with the same period in the previous year, it grew by 6%. As part of life insurance, gross written premium for the first three quarters of 2010 was Denar 230 million which is an increase of 18% as compared to the same period in 2009. The total gross premium at the end of the third quarter of 2010 (both life and general) amounts Denar 4,704 million (a growth of 6.9% comparing to the same period last year).

Life insurance in the Republic of Macedonia is at a low level of development in comparison with the member states in the EU. Taking into consideration the continuous growth and the small number of insurance companies offering this product, the expectations are that this segment will continue to grow in near future. The above-mentioned data indicate that the households do not consider the life insurance as an opportunity for savings or investments.

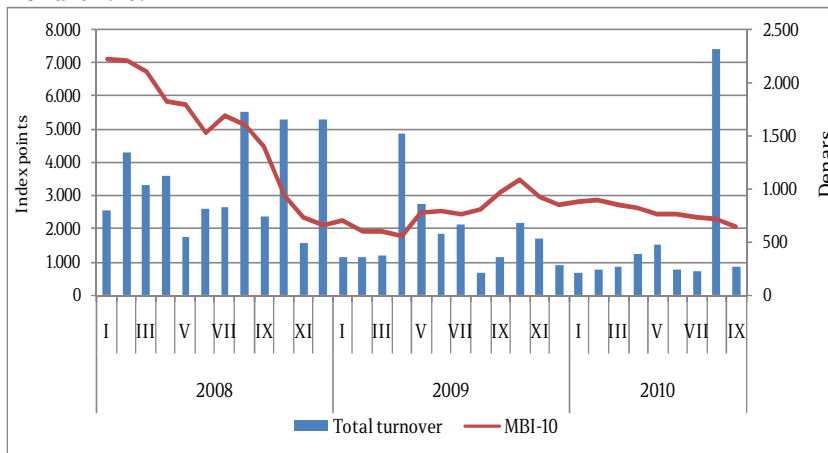
During the first nine months of 2010, a total of 818.719 general insurance policies were sold, which is a 9% increase when compared to the analyzed period of the previous year. On the other hand, the number of life insurance policies sold amounted 24.137 being an increase of 15% comparing to last year. Thus, the total number of insurance policies sold amounted 842.316 being an increase of 9% comparing to last year.

**Capital market.** In 2009, the Securities Exchange Commission approved seven issues of shares, all through private placement. The total value of the approved issues amounted EUR 88,2 million. The existing five fund management companies managed eight open-ended investment funds along with two custodian banks. The total net asset value of the open-ended investment funds amounted to about EUR 2,5 million, while their average yield was 21.8%.



On December 31<sup>st</sup> 2009, 36 companies were listed on the Macedonian Stock Exchange with total market capitalization to almost EUR 640 million. Macedonian Stock Exchange Index (hereinafter MBI10) was 2,751.88 index points. In 2009, the total turnover on the Macedonian Stock Exchange was around EUR110 million. In the period January-September 2010, four permits for issuance of securities, with total value of EUR 54,3 million, were provided.

Chart 2.10. Total turnover and MBI-10



Source: Macedonian Stock Exchange

The number of authorized market participants during the period of January - September 2010 has decreased by four, amounting 21 as of 30<sup>th</sup> of September, 2010. In addition, during the same period, four fund management companies managed six open-ended investment funds. The total net asset value of the open-ended investment funds in this period amounted EUR 2,26 million. In the period January-September 2010, 8 private fund management companies were registered which managed 13 private funds with total value of EUR13,22 million.

The turnover on the Macedonian Stock Exchange in the period January - September 2010 was around EUR74,28 million, while the total market capitalization was EUR 2,07 billion. In the period January - September 2010, 34 companies were listed on the Macedonian Stock Exchange and MBI-10 index amounted 2,445,66 index points.

**Leasing sector.** As of September 30<sup>th</sup> 2010, there are 11 licensed leasing companies on the financial leasing market in the Republic of Macedonia, out of which 9 are active. In March 2010, the Ministry of Finance revoked the license for performing financial leasing of two companies, while in Q3 2010, it issued such licenses to two new companies. Thus, as of September 2010 inclusive, number of leasing companies was unchanged in relation to the end of 2009.

According to data for the first three quarters in 2010, signs of recovery of leasing sector were seen. Thus, value of total assets of leasing companies was Denar 9,426 million on September 30<sup>th</sup> 2010, being an increase by 9.8% compared to the same period in 2009. Assets of leasing companies participate with 2.2% in GDP, while their share in total assets of the financial sector is 3%. Total capital value of leasing companies is Denar 544 million (an increase by 87% in relation to the same period in 2009) and it accounts for 0.13% in GDP.



Unlike 2008, when leasing industry was fastest growing compared to other segments on the financial market, in 2009, as a result of the financial crisis, activities of leasing companies experienced the largest slowdown. In 2009, leasing companies realized total operating loss for Denar 18 million. As of September 30<sup>th</sup> 2010 inclusive, the situation was similar, when leasing companies realized operating loss in the amount of Denar 14 million. However, taking into consideration that most of the leasing companies are new on the market, such loss is expected to a large extend.

By September 30<sup>th</sup> 2010, 1,110 new contracts were concluded, being a decline by 43% in relation to the same period of 2009, while the value of concluded contracts amounted to Denar 3,669 million, i.e. an increase by 19% compared to 2009. Legal entities are still most frequent users of leasing services (legal entities participate with 63% in total value of newly concluded contracts). Average interest rate on newly concluded leasing contracts is 9.84%.

Ownership structure of the leasing sector remained unchanged on September 30<sup>th</sup> 2010 compared to 2009, characterized with dominant foreign capital (around 99.5%). Foreign financial institutions own most of the foreign capital, i.e. 84.8%, while foreign non-financial legal entities (14.66%) and foreign physical persons (0.07%) own the remainder.

Increase in the offer and quality of services rendered by the leasing companies and intensification of efficiency when selling are expected to strengthen their competitive position in relation to non-banking institutions, as well as retail banking, as a segment of the banks' financial activities. Such expectation is also based on the tightening of regulatory requirements for banks, in particular in the field of household crediting. However, possibility for further growth of leasing companies depends, to a great extent, on their capacity to ensure additional financial potential to finance their activities.



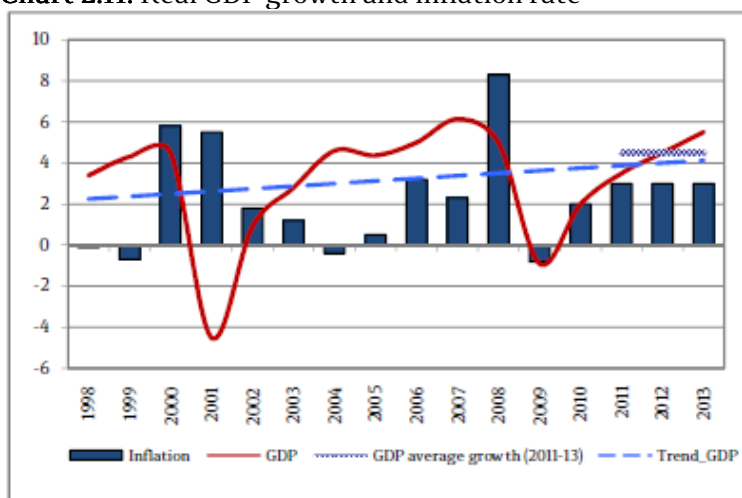
## 2.2. Medium - term macroeconomic scenario

Maintenance of macroeconomic stability and recovery of the economic growth are imperative in the coming medium-term period.

**Medium-term macroeconomic scenario.** The medium - term macroeconomic scenario for the period 2011 - 2013, relies on the expected positive developments in the global economy and in particular the EU economy, as major trading partner of the Republic of Macedonia. In addition, medium-term macroeconomic scenario encompasses both the policies and the measures undertaken and planned by the Government of the Republic of Macedonia during the analyzed period.

Accordingly, the economic activity in the Republic of Macedonia is expected reach the growth rates realized before the global economic crisis hit the Macedonian economy. Average real economic growth in the period 2011 - 2013 is projected at the level of 4.5%, with prospects for more dynamic economic growth in 2012 and 2013, i.e. projected growth rates of 4.5% and 5.5% respectively. Real GDP growth in 2011 is expected to be around 3.5%.

Chart 2.11. Real GDP growth and inflation rate



Source: State Statistical Office and calculations and projections of the Ministry of Finance

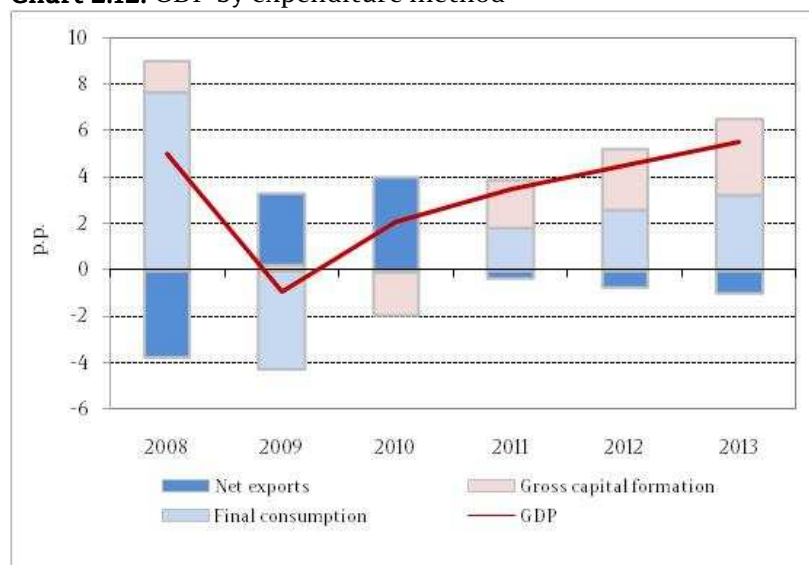
Analyzing GDP from the production side, the highest value added during the analyzed period is expected in the construction sector, with average real growth rate around 7%, mostly as a result of Government Programme for infrastructure projects for improvement of transport network in the country, improvement of education and health sector conditions, etc. Industry, following slow recovery in 2010, is expected to experience faster growth in the period 2011 – 2013, with real growth rates from 5% to 7.5% on annual basis. Hence, the share of industrial production in total output is expected to surge from 21.7% in 2010 to around 23% in 2013. Services sector, participating mostly to GDP creation, is actually the driving force of economic growth, contributing with 1.5 p.p. in 2011 and 2.2 p.p. in 2013. In accordance with the envisaged trends in Industry, highest growth rates of 5.4% in average among services, are expected in the Sector – transport, storage and communications during the analyzed period. Growth rate in the financial services sector is expected to range between 3.5% and 5%. Agricultural production, expected to be stimulated by increased subsidies for agriculture support, including



Budget funds and funds under IPARD, is projected to grow in average by around 3.5% in the period 2011 – 2013.

Analyzing GDP from expenditure side, domestic factors, i.e. private and investment consumption, in the period 2011-2013 is expected to have positive contribution to growth (see Chart 2.12.) unlike the expectations for 2010. Investment, following the expected contraction in 2010, are expected to grow between 10% and 11% on average in the period 2011 – 2013. Gradual strengthening of investors' confidence on global level is expected to contribute to intensification of capital flows and FDI increase, which, during the analyzed period, are expected to account for 4.5% of GDP in average on annual basis. Sound macroeconomic fundamentals, implemented reforms for business climate improvement, implemented reforms in the tax sphere and the reforms implemented and planned in the field of social contributions are expected to have a stimulating effect for both foreign and domestic investors. Fiscal policy is expected to provide additional impetus to investment demand through the planned increase of capital expenditures in the coming period (pursuant to the 2011 Budget, capital investments are envisaged to grow by 31%). In addition, orientation towards external financing of the budget deficit, as well as expectations for deposit growth, give potential opportunity for the commercial banks to extend the portion of funds placed to the private sector, thus stimulating credit activity.

**Chart 2.12.** GDP by expenditure method



Source: Calculations and projections by the Ministry of finance

Private consumption in the period 2011 - 2013 is anticipated to increase at an average real rate of around 3%. Projections are based on expected moderate increase of wages and the number of employees, expected growth of household credits as well as maintenance of high level of growth of private transfers. Increase in public consumption is anticipated to be moderate, ranging between 1.0% and 1.5% in the period 2011 - 2013.

As regards external sector, both export and import are expected to grow with approximately the same dynamics. Expected higher utilization of production capacities will have positive effect on export, leading to accelerated import of electricity. In addition, realization of the announced investments in technological and industrial development zones (TIDZ: hereinafter) is expected to lead to acceleration of export and



improvement of its structure on long run, while on the short run, it is also expected to improve import structure, taking into account that realization of these investments leads to larger import of investment goods, raw materials and intermediate goods. Real growth rate of export is expected to range between 7.2% and 8.4% in the period 2011-2013, while projections on import growth range between 6% and 7.8%. Chart 2.12. shows the share of growth of GDP components.

**Labor Market.** Envisaged economic growth in the period 2011-2013 is expected to have positive effect on labor market developments. According to the projections, an average increase of number of employees by 3.3% is being expected on an annual level. This in turn, will result in decline in the number of unemployed persons by 3.5% in average in the period 2011 - 2013. Additional employment increase is also expected on the basis of increase in labor force, which is expected to grow by 1.2% in average during the analyzed period. Such trends imply employment rate to increase to 41.2% in 2013, while unemployment rate is projected at the level of 27.6%. Number of active population in 2013 is expected to reach 56.9% of the working - age population.

In the period 2011-2013, a moderate real growth of wages is expected. Real growth of average net wage in 2011 is expected to account 1%, similar to the growth of average gross wage. In the coming period, uneven growth of average net and gross wage is projected, taking into account the envisaged reduction of social contribution rates. In 2013, average net wage is expected to grow, in real terms, by 5.2%, while average gross wage is expected to be around 4%.



### Box 1. Employment Elasticity

Employment elasticity is a useful indicator to analyze the type of unemployment in the Republic of Macedonia. In particular, we would like to see how much the fluctuations in the number of employees are result of output movements. Elasticity ratio ( $\beta$ ) calculated by regression and as shown below, it amounts 0.36.

$$l_{emp} = c + \beta * l_{gdpr}$$

where:

$l_{emp}$  – is logarithm for the number of employees

$l_{gdpr}$  – is logarithm from GDP by constant prices

Regression results also point out to relatively low level of explanation of variations in the number of employees with variations in the production. Set

determination ratio is 0.51, i.e. 51%. For a more

detailed analysis of the employment, more variables need to be observed and more sophisticated econometric

techniques need to be used. However, the goal is to test the relation among the variables used. Thus, the analysis shows that the unemployment in the Republic of

Macedonia is structural, and its more significant reduction requires high and sustainable economic growth, further implementation of the structural reforms in the economy, the education, etc.

Chart 2.13. Employment Elasticity



Source: Calculations and projections of Ministry of Finance

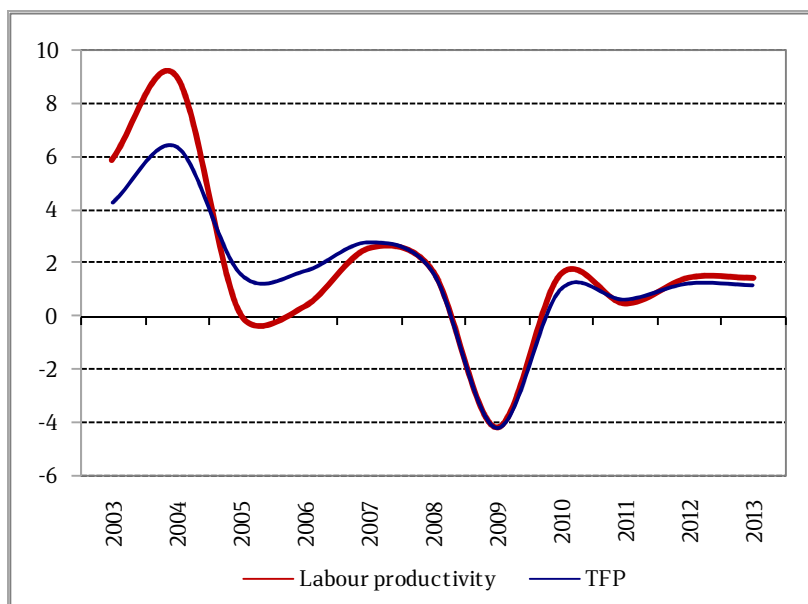
There is scatter plot between GDP growth and employment. Vertical axis shows real GDP growth, while the horizontal one presents employment increase. The chart shows three conditions of connection of observed variables. Upper right square refers to years of concurring increase in the number of employees and GDP. Period 2011-2013 belongs to the same square. Lower right square refers to years of decline of economic activity, accompanied by increase in the number of employees. The explanation for results about the year of 2009, comes from the implementation of "gross salary" reform, while the explanation for 2001, comes from the internal conflict when employment increased as a result of the fact that more people were engaged in the Army and police forces. However, as is shown on the chart in the years of 2002 – 2004, despite the positive economic growth, the number of employees declined. Thus, these years are included in the upper left square in the chart.





**Sources of growth.** In 2009, economic activity in the Republic of Macedonia declined by 0.9%. However, positive developments were registered on the labor market, mostly as a result of the “gross wage” reform, which started to be implemented from January 2009. Number of employees increased by 3.4%, implying decline of labour productivity by 4.2%. Capital stock also surged by 3.1%. Such trends resulted in decline of total factor productivity<sup>9</sup> (TFP hereinafter) by 4.2%. Chart 2.14. shows labor productivity and TFP in the period 2003-2013.

**Chart 2.14.** TFP and labor productivity (growth rates)



Economic recovery in 2010 and growth intensification in the period 2011 - 2013 are also expected to be underpinned by TFP growth, contributing, in average, by around 22.6% to economic growth. Labor is expected to have highest contribution to economic growth of 43.7%. Physical capital, according to the projections on investment growth, in the period 2011-2013, is expected, to grow by 3.7% in average, thus contributing by 33.7% to the overall economic growth.

Labor market conditions, i.e. high unemployment in the country, leave room for labour to be a significant contributor to economic growth. Therefore, these figures should be considered with a certain level of caution, above all, due to the high share of employment in the informal sector, which is not included in the calculation of TFP.

**Potential growth.** One of the main parameters used when projecting basic macroeconomic aggregates is the potential GDP growth in the Republic of Macedonia. Two methodologies have been used to calculate the potential output. The first one, belonging to the group of statistical approaches, is the Hodrick-Prescott trend estimation, according to which potential GDP growth is projected to 3.6%<sup>10</sup>.

<sup>9</sup> TFP is actually (Solow) residual of growth of other factors to economic growth, labor and capital. When calculating TFP, depreciation rate of accumulated capital of 10% was used, while average value as regards capital income for the period 1998-2009 is estimated to 41% and the rest (59%) is part of labor income.

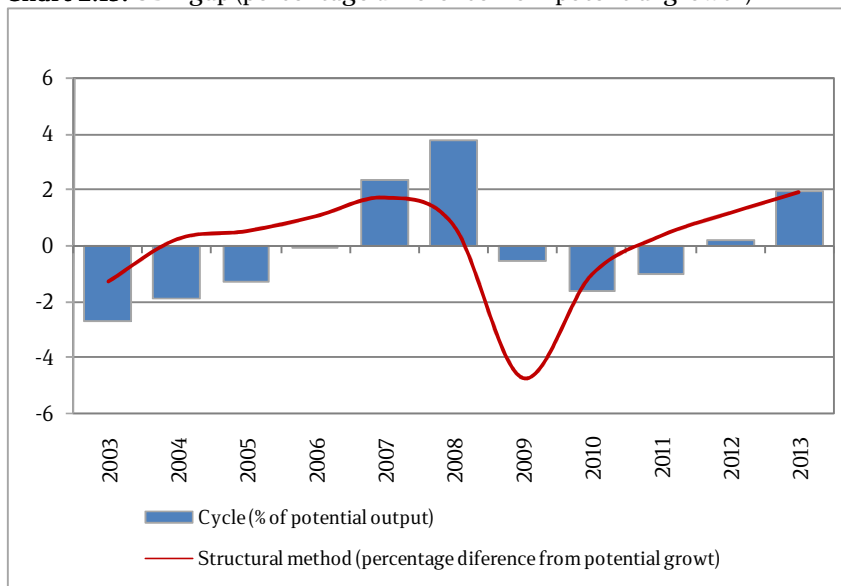
<sup>10</sup> The year of 2001 is excluded in the calculation, as a result of non-economic developments.



Second methodology on determining potential growth is the structural approach. Thus, according to “*production function*” approach, based on the functional relation between GDP and capital and labor force, potential growth is 3%. Namely, in addition to historical data, medium-term assessments on growth of employment and investments were used when doing the calculations. Thereby, Hodrick-Prescott filter is applied at all growth components.

GDP gap per year, according to the structural method, as well as the cycle expressed as percentage of potential output, are shown in Chart 2.15.

**Chart 2.15.** GDP gap (percentage difference from potential growth)



Source: Calculations and projections of Ministry of Finance

As is shown on the chart, the cyclical component of the output entered into negative zone in 2009, as a result of the effects of contraction of global economy on the Macedonian economy. In 2010, as post crisis year, GDP gap is expected to also be negative, however, significantly narrowed compared to 2009. In 2011, economy growth is expected to be closer to the estimated average potential growth that will contribute to a narrowing of the cyclical component of output. In 2013, the projected growth of production is higher than potential growth, resulting in a positive GDP gap.

**Inflation projection.** In 2011, the inflation is expected to range within the interval of 2-3%. The factors on the supply side are anticipated to have dominant influence on the inflation. The projections for further recovery of the world economy and the economies of our most important trading partners imply also relatively higher inflation level in these countries relative to the preceding year. The rise in the world food prices, which began in the third quarter of 2010, is expected to have the largest impact on the domestic inflation. Simultaneously, according to the expectations, the global growth will result in oil price increase, although significantly more moderate compared to the increase in the previous year. From the demand side, despite the estimates for revival of the domestic economy in 2011, however, the economy growth is expected to be below the potential growth. Thus, no pressures coming from the demand side are expected on inflation.

Within 2012 - 2013 period, the inflation rate is expected to remain low and stable, at the level of about 2-3%. Such a dynamics is in line with the anticipated movement of the

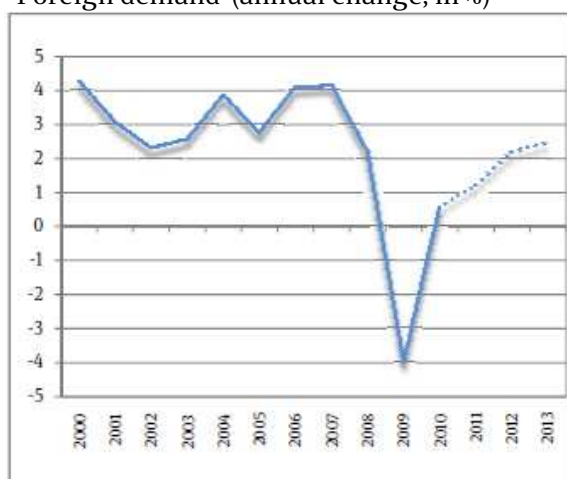


external inflation, having in mind the large dependence of the domestic prices on the import prices, as well as on the world prices of basic products, especially oil. Also, the inflation dynamics is conditioned by the expected movement trajectory of the domestic demand and the production gap. With the gradual intensification of the economic activity and narrowing of the negative production gap, within 2012 - 2013 period, certain inflation impulses by domestic demand can also be expected. The main risks regarding the medium-term inflation scenario are related to the movements of the world food prices, taking into consideration the dominant share of this component in the index, as well as to the energy sources prices, which could have also transmission effects on other prices in the economy. The assumption for the contribution of the domestic demand to the inflation is also important, envisaging its gradual strengthening, in conformity with the anticipated recovery of the domestic economy.

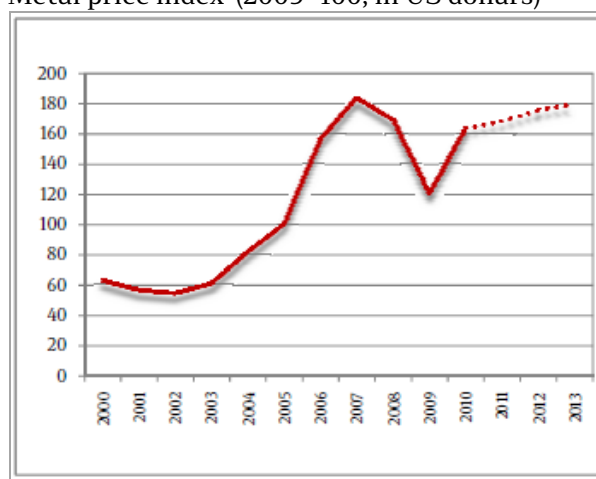
**Projection of the Balance of Payment.** Observed on a medium-term basis, the trends in the current account are conditioned, to great extent, by the recovery of the global economy. The intensified global economic activity can stir the expectations for bringing back the domestic economy in the initial pre-crisis condition, following up the previous profile of maintenance of larger trade deficit on a medium-term and relatively larger on current account gap, as a result of the increase in the domestic demand and higher imports on the basis of the intensified activity given higher FDI inflows. On a medium-term basis, prevailing of the positive effects of the foreign investments relative to the exports can be expected, thus narrowing the current account deficit.

**Chart 2.16.** Main assumptions in the projection of the balance of payments

Foreign demand (annual change, in %)



Metal price index (2005=100, in US dollars)

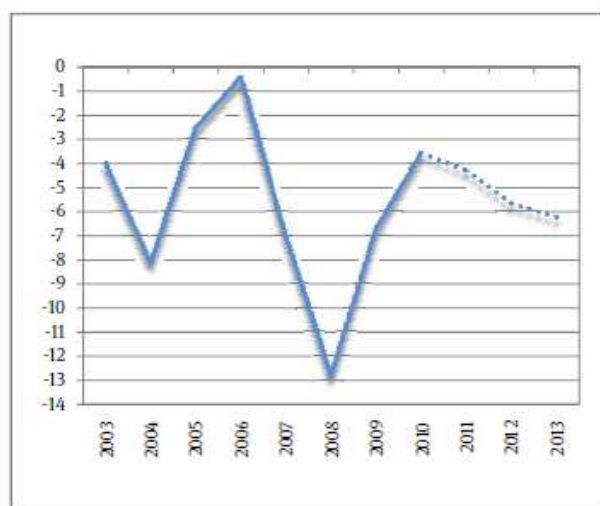


Source: Consensus forecast, October 2010 and World Economic Outlook, October 2010

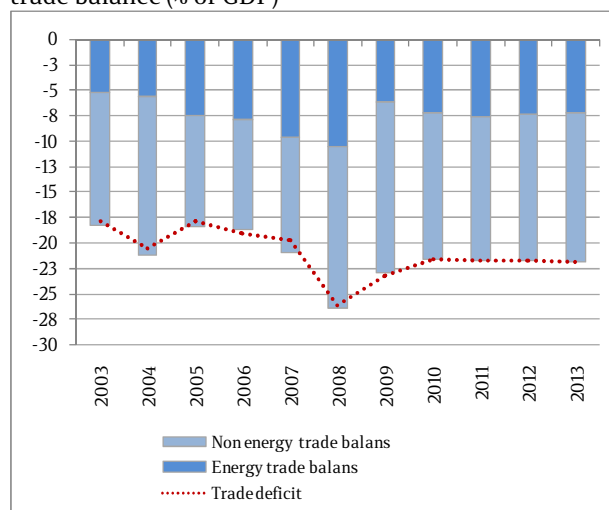
In 2011, the current account deficit is anticipated to be around 3-4% of GDP. Main factor for the slight worsening of the current account deficit is the expected reduced surplus in the private transfers, in conformity with the estimates for the slower transfers growth in 2011 and their lower share in GDP, following the extremely high level in 2010. On the other hand, minimal widening of trade deficit is expected, being consistent with the

estimates for moderate growth of the domestic economy in 2011. In addition, opposite to the huge price shocks evident in the previous years, in 2011, the changes in both the export and the import prices are estimated as moderate.

**Chart 2.17.** Current account (% of GDP)



**Chart 2.18.** Trade deficit - energy and non-energy trade balance (% of GDP)



Source: National Bank of the Republic of Macedonia

Within 2012 - 2013 period, the current account deficit is expected to deepen even more and to maintain the level of about 4-6% of GDP. With regards to current account components, in 2013 the trade deficit is expected to register slight deepening and to reach 21-22%, which is in line with the expected intensification of the economic activity and the import dependence of the domestic economy. Additional reason for the deepening of the current account deficit is the continuous gradual decrease in the inflows based on private transfer. Thus, the private transfers would comprise 17-18% of GDP in 2013, opposite to the percentage share of over 18% in 2010. Within the "income" category, in 2012 - 2013 period, increase in the net outflows is projected, due to the anticipated higher outflows of dividends to foreign investors. Such a presumption is based on the expectations that in terms of higher FDI inflow, intensified economic activity and favorable financial results, higher outflow on the basis of dividends to foreign shareholders can also be expected. The services' balance is expected to be maintained on a positive level, although with deceleration tendency.

Contrary to the relatively small broadening of the current account deficit, in 2011 high growth of the capital inflows is expected, whereas the share of capital inflows in GDP is expected to reach 6.8% of GDP, opposite to their level of 2.8% in 2010. The recovery of the world economy, the stabilization of the global financial flows, higher foreign investors' confidence, as well as rising need of additional finances are factors that influence towards increase in the private financial flows (primarily FDI). Considerable growth is expected of Government debiting abroad, in line with the projected budget deficit and the financial construction for its funding.



In 2012 - 2013 period, the level of the net inflows on capital and financial account is expected to be preserved at roughly 7%, in line with the expectations for gradual normalization of the financial markets, lower uncertainty and improvement of the foreign investors' perceptions. The FDIs are expected to mount gradually and reach about 5% of GDP in 2013, approaching to the level common for the years with the most favorable performances in this regards. With the recovery of the domestic economic activity, new adequate debiting of the private sector is anticipated, with the private sector's debt being expected to register additional increase in 2012 - 2013 period. Within the portfolio investments on a medium run, the trend of net outflows is expected to continue, which will mainly arise from the investment of the domestic pension funds on the external capital markets.

In line with the projected developments on the capital and financial account, in 2011-2013 period the gross foreign reserves are expected to increase and to preserve the level of four-month coverage of import of goods and services of each following year. Such a level of foreign reserves acts as a support to the strategy of foreign exchange rate targeting.



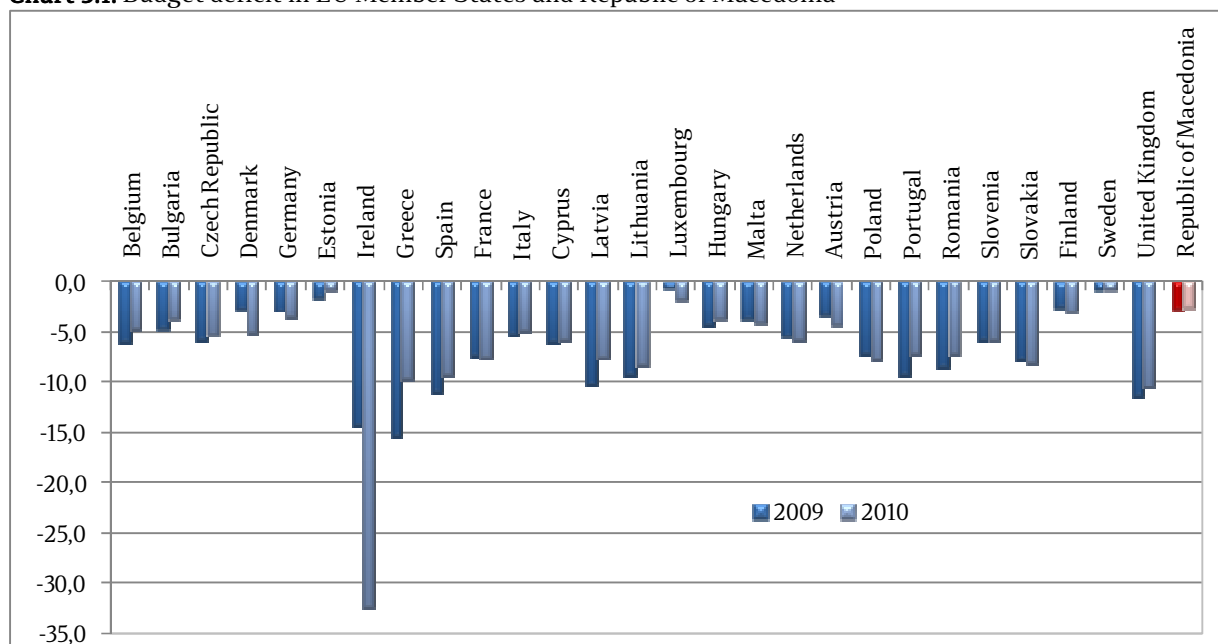
## **PART III**

### **Public Finances**



As regards public finance, in the past period, disciplined and prudent fiscal policy and public debt management policy were implemented. Fiscal policy in 2009 and 2010 managed to achieve a reasonable balance between the two main goals: the need to maintain macroeconomic stability on one hand, and on the other the need to encourage economic activity so to offset the negative consequences from the global economic crisis. The optimality fiscal policy when achieving these goals can be evaluated according to the level of Budget deficit.

**Chart 3.1.** Budget deficit in EU Member States and Republic of Macedonia



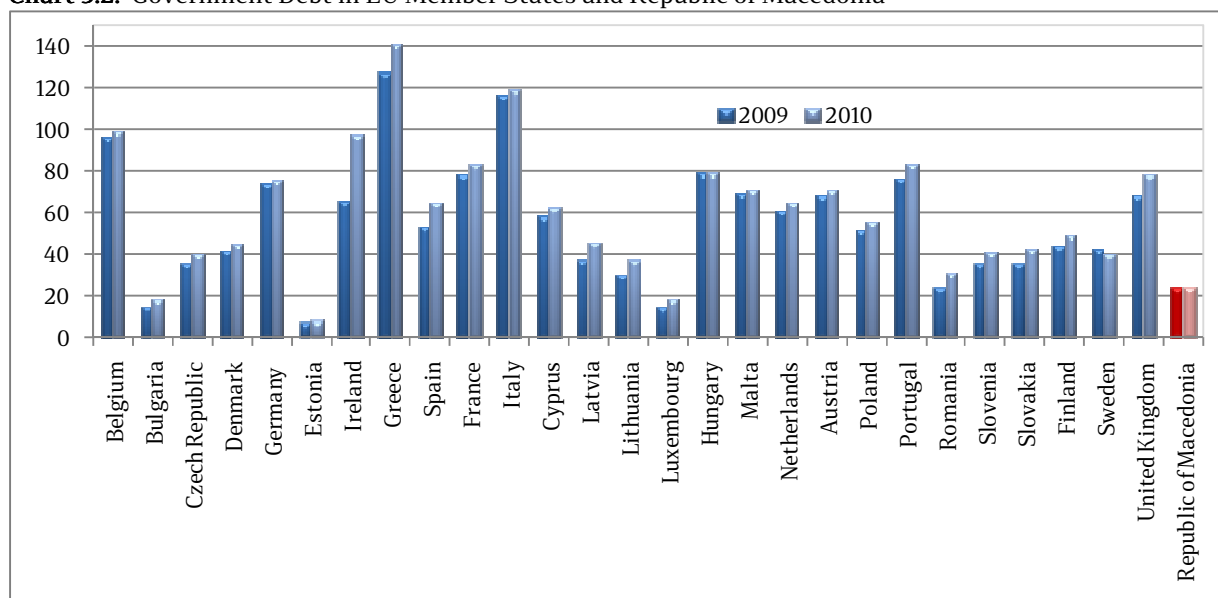
Source: Eurostat, European Commission Economic Forecast, Autumn 2010

Despite all challenges of the global economic crisis, Budget deficit in the Republic of Macedonia in 2009 was held at a moderate level of 2.7% of GDP. As shown on the Chart 3.1., it is one of the lowest Budget deficits in the EU.

Moreover, Republic of Macedonia is among the countries with lowest level of government debt (23.7% of GDP in 2009) compared to the EU countries (average 74%) as is shown on the Chart 3.2. The low level of government debt which is due to early repayment of loans in solid economic years (2007 and 2008), allowed for the Republic of Macedonia to be one of the few countries in the SEE region, which have fiscal space for moderate borrowing in order to maintain higher level of economic activity in conditions of prolonged global economic downturn, without questioning the ability to recover the debt.



**Chart 3.2.** Government Debt in EU Member States and Republic of Macedonia



Source: Eurostat, European Commission Economic Forecast, Autumn 2010

In the period 2011-2013, fiscal policy will feature further improvement of quality of public finance, disciplined management of the budget funds to result in maintenance of low fiscal deficit and maintenance of public debt at a sustainable level. Through more efficient usage of budget funds in development programmes and infrastructure investments, fiscal policy will aim at maintaining the macroeconomic stability and revival of economic activity.

On the medium run, fiscal policy is balanced between realization of two objectives:

- on the short run, to respond to the need to mitigate fluctuations in the business cycle, i.e. to lead to neutralization of consequences of the global economic crisis by conducting counter cyclical (in this case, moderate expansive) fiscal policy; and
- on the long run, fiscal position to be driven by the need to establish sustainable level of public debt, by maintaining moderate level of budget deficit, which would not lead to increase in the level of public debt above the long-term sustainable level.

### 3.1. General Government Budget Balance and Debt Stock

#### 3.1.1. Actual State-of-Play and Medium-Term Expectations

**Actual state-of-play in 2009.** Budget spending in 2009 was counter cyclical which helped to mitigate the decline in the economic activity caused by the global recession. Timely and effective reaction by adjusting fiscal policy to the overall economic developments imposed the need for appropriate fiscal adjustment and consolidation of public finances, through the adoption of two supplementary Budgets. Main reasons for the Budget revisions were the realized macroeconomic indicators, lower realization of

budget revenues and the need to limit public spending in order to retain the planned budget deficit of 2.8% of GDP, so as to preserve the macroeconomic stability.

The total revenue of General Government Budget<sup>11</sup> (State Budget and budgets of local governments) in 2009 amounted to Denar 135,927 million (33.3% of GDP<sup>12</sup>), while total expenditure reached Denar 147,106 million (nearly 36% of GDP). Deficit accounted 2.7% of GDP, which is within the originally projected 2.8% of GDP.

Within total revenues of the Central Budget of the Republic of Macedonia in the amount of Denar 128,498 million (31.4% of GDP), 85.5% was realized on the basis of tax revenues and social contributions. Tax revenues in 2009 were realized in the amount of Denar 70,754 million (17.3% of GDP). The share of revenues collected on the basis of VAT accounted 49.7%, thus contributing the most in the total revenues. Social contributions amounted to Denar 38,837 million i.e. 9.5% of GDP. Non-tax revenues were realized in the amount of Denar 16,402 million i.e. 4% of GDP. Capital revenues accounted for Denar 1,167 million, while revenues from donations reached Denar 833 million, i.e. 0.3% and 0.2% of GDP respectively.

Total expenditures of the Central Budget of the Republic of Macedonia in 2009 amounted to Denar 139,393 million, i.e. 34.1% of GDP. Total of Denar 22,699 million (5.5% of GDP) was paid for wages and allowances. Expenditures for goods and services reached the amount of Denar 16,220 million (4% of GDP), while social transfers accounted for Denar 61,142 million (15.1% of GDP). Funds in the amount of Denar 36,455 million were allocated for regular payment of pensions, while Denar 2,271 million was allocated for payment of unemployment benefits. Funds to finance health services and benefits amounted to Denar 18,711 million (4.6% of GDP). Regarding other transfers from the Budget, grants were transferred to local government units on regular basis, whereby Denar 1,162 million from VAT revenues was transferred to local level. Additional Denar 11,620 million was transferred in the form of block grants for financing the transferred competences, as well as earmarked donations for financing the operating costs of local public institutions. Denar 2,445 million was allocated for regular servicing of liabilities on the basis of interest, Denar 1,434 million out of which was interest on external borrowing. Capital expenditures amounted Denar 13,428 million, i.e. 3.3% of GDP.

The Central budget deficit in 2009 amounted Denar 10,895 million (2.7% of GDP) which was financed mostly from external sources (PDPL and Eurobond), as well as from domestic sources.

**Actual state-of-play in 2010.** Fiscal policy in the first nine months in 2010 was implemented within the prolonged effects of the global economic crisis, above all due to

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<sup>11</sup> See Table 2 in the Appendix 2

<sup>12</sup> GDP at current prices of Denar 409.100 million.

the unexpected external shock as a result of the debt crisis in Greece and other European countries.

Hence, performance of revenues was in line with the planned dynamics. Thereby, starting March 2010, tendency of revenue improvement was observed both in terms of planned amounts and in terms of respective revenues in 2009. Total revenues in the General Government Budget (Budget of the Republic of Macedonia and the budgets of local government) amounted to Denar 104,865 million in the first nine months, while total expenditures reached the amount of Denar 110,420 million. Deficit accounted for 1.3% of GDP, as a result of the central government budget deficit of 1.5% of GDP and the low surplus from current operations of LGU of 0.2%.

Within total revenues of the Central Budget of the Republic of Macedonia in the amount of Denar 97,975 million (which are higher by 3.3% compared to the same period of 2009), Denar 82,527 million was realized on the basis of tax revenues and social contributions, i.e. 84% of total genuine revenues. Tax revenues during this period were realized in the amount of Denar 54,279 million which is 3.7% higher when compared to their realization in the first nine months of 2009. Revenues collected on the basis of VAT accounted for the most in the total revenues, i.e. 51%. Social contributions are almost at the same level comparing to their level last year, amounting to Denar 28,248 million. Non-tax revenues were realized in the amount of Denar 13,100 million, including payment of National Bank profit in the amount of Denar 408 million, administrative and court fees in the amount of Denar 1,303 million, as well as collected road toll in the amount of Denar 1,378 million. Capital revenues accounted for Denar 824 million, mainly on the basis privatization and lease of construction land, as well as sale of social flats. Revenues from donations reached Denar 1,523 million, which the budget users realized on the basis of multilateral and bilateral cooperation.

During the analyzed period, total expenditures of the Budget of the Republic of Macedonia amounted to Denar 104,561 million which is higher by 2.9% when compared to their level during the same period last year. Total of Denar 16,975 million was paid for salaries and allowances, which is less by 0.2% comparing to the first nine months of 2009. Expenditures for goods and services are lower by 9.9% amounting Denar 10,692 million, while social transfers are higher by 3.7% when compared to the first nine months of 2009, thus amounting Denar 47,631 million. Obligations of the state as regards social protection of the most vulnerable categories, child allowance and so on, were serviced on regular basis. Funds in the amount of Denar 27,990 million were allocated for regular payment of pensions, while transfers to private pension funds accounted for Denar 2,329 million. Denar 1,538 million was allocated to the Employment Agency for payment of unemployment benefits. Funds to finance health services and benefits amounted to Denar 14,285 million. Regarding other transfers from the Budget of the Republic of Macedonia, grants were transferred to local government units on regular basis, whereby Denar 904 million from VAT revenues was transferred to local level. Additional Denar 8,923 million was transferred in the form of block grants for financing the transferred



competences, as well as earmarked grants for financing the operating costs of local public institutions. Agricultural subsidies were continuously extended during this period of the year.

Denar 2,262 million was allocated for regular servicing of liabilities on the basis of interest, Denar 1,514 million out of which was interest on external borrowing. Capital expenditures were executed with better dynamics compared to the previous years and they are higher by 20.4% when compared to their level in the first nine months of 2009.

**Table 3.1.** Central Budget of the Republic of Macedonia

Denar million	2010 Budget	Realization in Jan-Sep 2010
<b>1. Total revenues</b>	138,617	97,975
1.1. Tax revenues and contributions	114,073	82,527
1.1. 1 Tax revenues	73,975	54,279
1.1. 2 Contributions	40,098	28,248
1.2. Non-tax revenues	18,475	13,100
1.3. Capital revenues	2,833	824
1.4. Donations	3,236	1,523
<b>2. Total expenditures</b>	149,174	104,561
2.1. Current expenditures	131,478	93,661
2.1.1 Salaries and allowances	23,029	16,975
2.1.2 Goods and services	16,074	10,692
2.1.3 Transfers	89,194	63,732
2.1.4 Interest	3,181	2,262
2.2. Capital expenditures	17,696	10,900
<b>3. Deficit</b>	-10,557	-6,587
<b>4. Deficit financing</b>	10,557	6,587
4.1 Inflow	18,645	11,749
4.1.3 External sources	14,256	2,632
4.1.3 Domestic source	3,989	2,912
4.1.4 Deposits/additional sources	400	6,205
4.2 Outflow	8,088	5,163
4.2.1 Repayment upon foreign borrowing	2,560	1,856
4.2.2 Repayment upon domestic borrowing	5,528	3,307

Source: Ministry of Finance

**Medium-term expectations.** Projections for revenues in the Budget of the Republic of Macedonia in the coming medium-term period are based on the realized revenues in the current 2010, as well as on the projected macroeconomic indicators for the coming period (expected growth of economic activity, employment, inflation, salaries and other relevant variables).

Projected revenues of the consolidate government budget in the period of 2011-2013 decline relatively (as a share of GDP), from 34.5% of GDP in 2011 to 32.5% in 2013. As a result of continuity in implementing disciplined budget policy, in the period 2011-2013,



total expenditures will experience decline from 37% of GDP in 2011 to 34.4% of GDP in 2013.

**Table 3.2.** Consolidated general government budget

Denar million	2011	2012	2013
Consolidated general government budget - Revenues	157,963	165,089	174,068
% of GDP	34.5	33.5	32.5
Consolidated general government budget - expenditures	169,543	175,936	184,267
% of GDP	37.0	35.7	34.4
Consolidated general government budget - deficit	-11,580	-10,847	-10,199
% of GDP	-2.5	-2.2	-1.9
Central government budget - revenues	87,661	91,673	96,028
% of GDP	19.1	18.6	17.9
Central government budget - expenditures	98,293	101,539	105,173
% of GDP	21.4	20.6	19.6
Central government budget - deficit	-10,632	-9,866	-9,145
% of GDP	-2.3	-2.0	-1.7
Budget Funds - revenues	46,065	48,880	52,464
% of GDP	10.0	9.9	9.8
Budget Funds - expenditures	47,013	49,861	53,518
% of GDP	10.3	10.1	10.0
Budget Funds - deficit	-948	-981	-1,054
% of GDP <sup>13</sup>	-0.2	-0.2	-0.2
Local government budget - revenues	24,237	24,536	25,576
% of GDP	5.3	5.0	4.8
Local government budget - expenditures	24,237	24,536	25,576
% of GDP	5.3	5.0	4.8
Local government budget - deficit	0	0	0
% of GDP	0.0	0.0	0.0
Gross Domestic Product	458,455	493,458	536,216

Source: Ministry of Finance

Such determined basic postulates of the fiscal policy actually mean further maintenance of the deficit at optimal medium-term level of around 2% of the projected GDP.

<sup>13</sup> This item includes the deficit of Pension and Disability Insurance Fund, Health Fund, the Agency for Employment and the Road Agency.



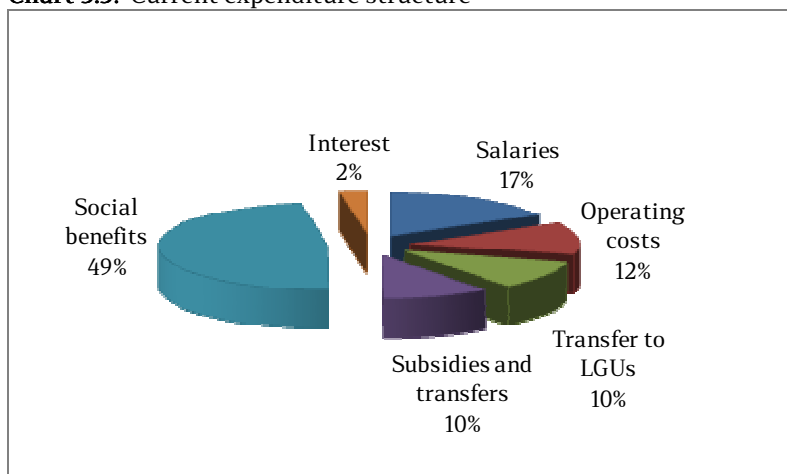
### 3.1.2. Fiscal Strategy

**Projected revenues in the Budget of the Republic of Macedonia.** Total genuine revenues for the period 2011-2013 are projected in the amount of around 29% of GDP, whereby, their share in GDP per year declines in line with the policy for reducing tax burden on the economy. Thereby, tax revenues account for around 54% in the projected revenue structure, followed by revenues on the basis of social contributions with around 29%, non-tax revenues and capital revenues with around 13%, while the rest of the revenues are expected to be realized from IPA funds. With respect to tax revenues, most revenues will be realized on the basis of VAT, personal income tax and excises.

Regarding the coming three-year period, projections for social contributions, which are genuine revenues of the Pension and Disability Insurance Fund, Health Insurance Fund and the Employment Agency, are made in line with the planned dynamics of reduction of social contribution rates, as well as the effects of the implementation of the reform for integrated collection of social contributions and personal income tax and the gross salary concept. Non-tax revenues in the next medium-term period account for around 10% in overall revenues, and the most significant is the share of revenues on the basis of administrative fees, road tolls and registration of vehicles. Projection of the revenues of the Budget of the Republic of Macedonia with regard to foreign donations in the coming period include the donations the budget users would realize for specific projects, as well as disbursements from the EU pre-accession funds.

**Projected expenditure in the Budget of the Republic of Macedonia.** Expenditure side of the Budget of the Republic of Macedonia for the period 2011-2013 is designed so as to support recovery of the Macedonian economy, overcome consequences from the crisis period and increase investments in infrastructure projects. Average share of expenditures in the Budget of the Republic of Macedonia in the next medium-term period is around 33% of GDP. Thereby, it is planned for their structure to be improved by increasing the share of

**Chart 3.3. Current expenditure structure**



Source: Ministry of Finance

capital expenditures from 11.9% in 2010 to 15.4% in 2013, and reducing current expenditures from 88.1% in 2010 to 84.6% in 2013. Such positive change in the structure of public expenditures is necessary to support the realization of the envisaged rates of economic growth and it corresponds to the commitment to continue implementing

restrictive budget spending as regards non-productive expenditures and expected inflow of investments to finance capital projects from both domestic and external sources (IPA and other funds).

When projecting the expenditures for the next period, the following assumptions were taken into account: a) as regards expenditures for payment of salaries and allowances, it is envisaged to continue with the strict control over new employments and the postponed increase of salaries, in order to stabilize general economic conditions and to complete the consolidation of public finances; and b) as regards current expenditures full and timely payment of pensions and social contributions is envisaged, as well as ensuring social welfare of the beneficiaries of these rights.

Thus, expenditures related to pensions were projected on the basis of the estimated growth of the number of pension beneficiaries and the calculated pension indexation in accordance with the projected growth of both the costs of living and the salaries. Projections of the necessary funds of Health Insurance Fund takes into account the effects from the planned controls for more efficient usage of funds, as well as the effects from the implementation of treasury system in the health sector, by fully applying the budgetary principles and the other reforms in this sector.

Within the medium-term projections of social allowances, funds are planned for regular coverage of obligations of the state towards the socially most vulnerable families in the form of social welfare, child allowance, allowances on the basis of rights of disabled persons, invalids of war and civil invalids and asylum seekers. Planned reforms in the social sphere, by simplifying the procedures for exercising these rights, as well as the effects from the integration of social centers in unique information system, will provide certain savings and proper targeting of these allowances towards the most vulnerable categories.

Envisaged reforms in the agricultural sector will create conditions for establishing an efficient and competitive agricultural sector and its successful integration in the EU. These reforms will be realized through increased financial support to farmers, and therefore subsidies in the amount of EUR 115 million are planned in 2011 and EUR 130 million in 2012 and 2013, as well as funds under the fifth component of IPA (IPARD) Programme.

To the end of achieving and maintaining positive economic growth rates, it is planned for public investments to increase by around 50% in the coming three years compared to the present level. Thus, investments are planned in the field of road, railway, energy and utility infrastructure, capital investments in correction institutions, improvement of conditions in education and health system, as well as investments in culture and social centers.



Regarding road infrastructure, implementation of the Regional and Local Roads Programme Support Project will continue on the basis of foreign financing, and construction of the rest of the Pan-European Corridor X will commence. In addition, activities for completing the commenced road sections and rehabilitation of the existing ones will continue. As for railway infrastructure, continuation of commenced activities for renewal of the rolling stock and modernization of railway line along Corridor X is envisaged, while funds from foreign sources will be provided for construction of Corridor VIII. Funds for reconstructions and maintenance of facilities in the field of education, sport, culture, child care and social protection are planned within the total amount of capital investments. At the same time, funds for continuation of the on-going multi-annual projects are envisaged, for which, obligations for procurement of medical equipment in the field of health, information technologies, transport and environment have been already undertaken.

In the period to come, it is planned to continue the implementation and commence the realization of several projects financed under foreign credits, which, will to a great extent contribute to successful completion of the commenced structural and reform processes.

With respect to judiciary, comprehensive reform efforts of the Government will continue to be supported through the Project for implementation of legal and judicial system reforms and institutional support, which contributes to reducing the costs for doing business and increasing the possibilities for job creation, as well as improving the efficiency and the effectiveness of the judiciary. To the end of ensuring and improving human rights, in relation to conditions for accommodation, hygiene, health protection and leisure of convicted and detained persons, implementation of the Project for Prisons Reconstruction in the Republic of Macedonia will commence in 2011, envisaged to be financed with a loan from the Council of Europe Development Bank (hereinafter: CEB). This Project envisages reconstruction of four correction institutions, which will contribute towards implementation of the international standards in this regard.

To the end of continuing the reforms for protection of property and legal affairs and registration of property rights, activities related to already commenced cadastre reforms, supported with the additional financing under the Real Estate Cadastre and Registration Project, will commence in the course of 2011.

Government measures and activities in the field of social policy are supported under the Conditional Cash Transfers Project financed by the World Bank, aimed at supporting the Government of the Republic of Macedonia in its efforts to reduce poverty of vulnerable groups. At the same time, by implementing the Project for Housing of Vulnerable Groups, 50% out of the total project costs will be provided under a loan from the Council of Europe Development Bank is aimed at providing access to appropriate housing, reduction of poverty and social exclusion.

Agriculture strengthening and accession Project financed with a loan from the World Bank will contribute to continuing the activities aimed at creating modern and competitive agricultural sector, being of special importance for the economic and social development of the country, thus supporting the Republic of Macedonia in acquiring absorption capacity for using IPA assistance and meeting the requirements for EU membership.

Government activities aimed at improving the management at local level are supported under the Municipal Services Improvement Project financed with a loan from the World Bank, which will enable municipalities and public utility enterprises to borrow and finance investment activities in line with their needs.

Regarding transport infrastructure, activities under the Second Trade and Transport Facilitation in South East Europe Project – TTFSE 2 will continue with increased intensity. In addition, the Agency for State Roads continues realizing the Regional and Local Roads Programme Support Project. This Project is financed by the World Bank and the EBRD. To the end of completing Corridor X, realization of the Corridor X Project, Motorway Section Demir Kapiya – Smokvica is planned, to be financed with support by EBRD and EIB.

With regards to railway infrastructure, implementation of two significant projects is planned to start in the coming period, those being the following: Rail Corridor X Project and Project for Construction of Rail Corridor VIII (Kumanovo-Deve Bair). In 2011, implementation of the Project for Construction of Gas Pipeline System in the Republic of Macedonia will start, aimed at supplying the business entities, the public sector and the households with cheap and environment friendly energy.

The Government of the Republic of Macedonia will continue to support the implementation of the national gas pipeline system in the country, where a construction of certain priority sections of the main pipeline section is being envisaged. With regards to this project, the Government took initial steps for provision of additional funds for implementation of the project, in addition to funds from the Budget and from several other sources such are funds from the obligations of the former Soviet union to the Republic of Macedonia and other international financial institutions such as EBRD and EIB. During 2011–2013, depending on the level of secured funds, the construction of the priority sections of the main pipeline (410 km) will commence.

For the purpose of improving the conditions in the health provider institutions, CEB provided funds in the amount of EUR 23 million for realization of the Project for the first phase of the Project for rehabilitation of Public Health Institutions in the Republic of Macedonia. Second phase envisages more significant construction activities in 18 Public Health Institutions, while the third one will cover full reconstruction of Clinical Center – Skopje, i.e. all other clinics, institutes and facilities within the Clinical Center.



Project for building Physical Education Facilities in Secondary Schools financed from the Budget and CEB will raise the level of physical education, taking into account its significance in improving psychophysical performance of pupils.

Water Supply and Waste Water Collection Project is one of the priorities of the Government of the Republic of Macedonia in the next three years. This KfW-funded Project will provide sustainable supply of drinking water. Realization of the second phase of this Project is also envisaged, covering larger investments (reconstruction of water-supply and sewerage networks) in the municipalities. First phase of the Zletovica Water Basin Utilization Improvement Project will be completed in 2010. Government of the Republic of Macedonia chose EIB as creditor of Phase II – irrigation facilities and Phase III hydroelectric power facilities. Realization of Phase II will contribute to high productive production of health food, which will lead to enhancing the competitiveness on the markets of EU Members States and increasing the export of crops of the Republic of Macedonia. Realization of Phase III, covering construction of eight small hydro-power plants along the flow of Zletovica River, will contribute to reducing shortage of electricity, safe, secure and quality supply of energy to consumers, increasing energy efficiency, as well as creating opportunities for job creation in the region. In addition, funds from EIB are expected to support the implementation of the Project for water supply and drainage of waste water which envisages investments in improvement of the communal infrastructure in all of the municipalities in the country.

First phase of the Programme for Irrigation of the Southern Valley of the River Vardar is expected to be completed during 2010. Programme for Irrigation of the Southern Valley of the River Vardar – Phase II will be financed with a loan from KfW, including expanding the land area for construction of irrigation systems on eight locations in the south part of the country.

**Projected Deficit and its Financing.** In line with the budget revenue and expenditure projections in the coming medium-term period, sustainable level of deficit of 2.5% in 2011 is planned, with a tendency of reducing the deficit to 2.2% in 2012 and 1.9% in 2013.

Deficit financing in the next medium-term period is planned to be mainly provided from foreign sources (favorable credits from IFIs, credit lines for financing certain projects, Eurobonds and other type of foreign borrowing). Foreign borrowing, as source of financing, will be used by budget users for specific projects and by the Agency for State Roads for construction and reconstruction of roads in the Republic of Macedonia. Maintaining moderate level of deficit, in conditions when significant amount of funds is allocated for infrastructure investments, is expected to have positive effects on the stabilization of the Macedonian economy and overcoming the negative consequences from the global economic crisis.





**Table 3.3.** Deficit and sources of financing

Denar million	2011	2012	2013
<b>Budget balance</b>	-11,584	-10,859	-10,204
<b>Deficit financing</b>	11,584	10,859	10,204
<b>Inflow</b>	19,661	16,401	26,698
External sources	19,361	16,301	26,678
Domestic sources	300	100	20
<b>Outflow</b>	8,077	5,542	16,494
Repayment upon external borrowing	2,951	3,426	14,485
Repayment upon domestic borrowing	5,126	2,116	2,009

Source: Ministry of Finance

**Local Government Budget.** In the coming medium-term period, the fiscal decentralization process will continue to the end of improving the administering and collection of local government revenues in line with the European Charter of Local Self-Government, i.e. right of municipalities to set the rate of taxation and the fee amount independently.

Successful implementation of the fiscal decentralization will, in particular, strengthen the local independence in generating revenues, being of essential importance for carrying out the municipality functions. Such independence will be also improved by modernizing tax policy and administration in relation to property taxes, taking into account that this tax should become much more important source of municipal revenues.

In line with the fiscal projections for the coming medium-term period, local government revenues are projected to stabilize at around 5% of GDP, whereby, increase of special revenues of municipalities is expected. Increase in the number of municipalities to be financed with block grants will contribute to increasing the transfer of funds for salaries, allowances and operating costs from the Central Budget to the local authorities for financing public local institutions in the field of education, social protection and culture. Policies for greater level of management of state-owned land are also expected to have effect thereto. Certain effect is also expected from the legal possibility for participation of private capital in the public sector, through public-private partnership, being at the same time stimulus for improving the quality of local services and increase of revenues.

Medium-term projections include the effects from the amendments to the Law on Financing Local Government Units, by which the percentage of VAT revenues increased from 3% to 4.5%. This increase will be implemented in phases by 2013, which will have effects on the increase of the revenues of municipalities in the coming years. Such approach demonstrates the commitment to gradual transfer of competences to local governments, as well as resources for their effective execution, without causing bigger disturbances in the functioning of certain activities.

Increase of special revenues and strengthening administrative capacity in managing the funds, additionally increase the opportunities for local authorities to borrow. Recent





amendments to the Law on Financing Local Government Units liberalized the conditions for municipalities to borrow. In addition, an important novelty in the Law is the possibility for the municipalities to appear on the capital market with issuance of bonds. Possibility to borrow, as percentage of the realized total revenues in the current budget of the municipality in the previous fiscal year increased to 30% for both short-term and long-term borrowing (compared to the previous legal solution of 20% for short-term borrowing, i.e. 15% for long-term borrowing). In addition, new instrument for assistance and financing of municipalities was introduced, in the form of short-term and long-term borrowing (up to five years at most) from the Budget of the Republic of Macedonia, to the end of overcoming time discrepancy of revenues and expenditures of the municipalities. Additionally, it is important to note that there are plans to increase the term of maturity of these loans to 10 years during 2011.

In the coming years, fiscal decentralization will enter in more advanced stage, in which the administrative capacity of municipalities will strengthen, thus contributing to stabilization of local government revenues as well. At the same time, financial management and control system, as well as independent internal control and audit will be additionally developed, by strengthening overall capacities of local authorities.

### 3.1.3. Structural deficit

Economic activity shows upward trend over time, however, when moving towards the trend line, the economy usually fluctuates above and below the long-term trend. Such cyclical trends in the economy also reflect on the fiscal developments, through automatic stabilizers, due to which the fiscal position of the state is actually blurred. Thus, calculation and usage of cyclically adjusted budget balance gives clearer picture of the fiscal policy.

**Table 3.4.** Aggregate fiscal indicators and cycle

	2007	2008	2009	2010	2011	2012	2013
Primary budget balance	1.4	-0.3	-2.1	-1.7	-1.8	-1.5	-1.2
Total budget balance	0.6	-0.9	-2.7	-2.5	-2.5	-2.2	-1.9
Production gap	2.3	3.8	-0.5	-1.6	-1.0	0.2	2.0
Absorption gap	0.8	1.3	-0.2	-0.5	-0.3	0.1	0.6
Cyclical component of the budget	0.6	-1.5	-1.9	-1.2	-1.5	-1.6	-1.8
Cyclically adjusted primary balance	-0.2	-2.2	-2.5	-1.9	-2.2	-2.3	-2.5
Cyclically adjusted total balance	0.8	0.5	-1.4	-0.4	0.2	0.4	0.6
Automated stabilizers <sup>14</sup>	0.3	-2.0	-0.3	0.5	-0.3	-0.1	-0.3
Fiscal impulse (of total budget balance) <sup>15</sup>	1.4	-0.3	-2.1	-1.7	-1.8	-1.5	-1.2

Source: Calculations of the Ministry of Finance

<sup>14</sup> Automated stabilizers are calculated as difference between the cyclical budget component in the current and the previous year.

<sup>15</sup> Fiscal impulse is calculated as difference between cyclically adjusted balance in the current year and the same indicator in the previous year.



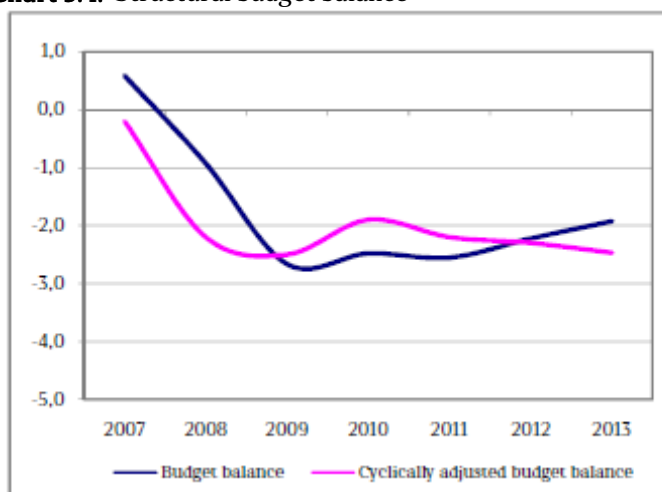
In the period of economic boom, automatic stabilizers have had positive impact on the budget balance. Hence, in 2007 and 2008 the impact of automatic stabilizers is estimated to be some  $\frac{3}{4}$  and  $\frac{1}{2}$  percent of potential output, respectively. In this period, cyclical component of the budget has been positive, causing for the cyclically adjusted budget balance to be lower than the realized one, amounting to -0.2% in 2007 and -2.2% in 2008.

In 2009, as a result of the high drop of domestic demand, automatic stabilizers had unfavorable impact on the budget balance. In addition, the moderate expansionary fiscal policy caused for the budget deficit to expand to 2.7% of GDP. Given the negative output gap, however, cyclically adjusted budget deficit was lower in the same year, amounting to around 2.5%, implying negative fiscal impulse of 0.3% of the potential output (see Table 3.4.).

In 2010, cyclical budgetary component is estimated to be negative, taking into account the expected trends in the economy, resulting in structural deficit lower than the projected one for the same year, estimated at 1.9%, and positive fiscal impulse of some  $\frac{1}{2}$  percent of potential output.

Based upon the assumptions for economic growth and its structure, as well as budget deficit projections, it is estimated that in the period 2011-2013 automatic stabilizers will have positive impact on fiscal trends, assessed at a level of 0.2% in 2011 up to 0.6% in 2013. Accordingly, fiscal policy in 2011 can be assessed as counter-cyclical one, while in 2012 the fiscal policy is assessed to be rather neutral and in 2013 certain pro-cyclical component is observed. Structural deficit in the same period shows upward trend, ranging from 2.2% in 2011 to 2.5% in 2013 (see Chart 3.4).

**Chart 3.4.** Structural budget balance



Source: Calculations of the Ministry of Finance

### 3.1.4. Public Debt Management

**Legal Framework.** Main objectives of public debt management, pursuant to the Public Debt Law are the following:

- stable financing of the needs of the state with minimum costs, on medium- and long- term, and with reasonable risk level; and
- development and maintenance of efficient domestic financial market.

The framework for the borrowing policy in the Republic of Macedonia is the medium-term Public Debt Management Strategy, adopted by the Parliament of the Republic of Macedonia. It sets the framework for external and domestic borrowing in the period 2010-2012 and provides guidelines for improvement of the features of the debt portfolio of the Republic of Macedonia.

In order to ensure resources for financing the needs of the state with the lowest possible cost on medium and long term with sustainable level of risk, according to the Strategy for Public Debt Management of the Republic of Macedonia for the period 2010- 2012, the following medium term targets are defined:

- the level of government debt in the next three years not to exceed 30% of GDP;
- the level of total public debt in the next three years not to exceed 40% of GDP;
- the amount of guaranteed debt in the next three years not to exceed 10% of GDP;
- the share of Euros in debt in total debt should not be below 70%.

**Debt of the Republic of Macedonia.** Government debt<sup>16</sup> at the end of the third quarter of 2010 amounted to 1,651.0 million, or 23.6% of GDP, which is significantly lower than the level set by the Maastricht criteria, under which the general government debt should not exceed 60% of GDP .

On the other hand, total public debt<sup>17</sup> of the Republic of Macedonia, pursuant to the Law on Public Debt and the GFS Methodology, amounted to EUR 2,393.1 million at the end of September 2010, and compared to the level at the end of 2009, it increased by EUR 264,3 million. In relation to GDP, total public debt amounted 34.2% in September 2010, and compared to 2009, it increased by 2.6 p.p.

During the analyzed period, internal public debt participated with 39.7% in the total public debt, while share of external public debt was 60.3%. Share of internal public debt increased by 4.2 p.p., as compared to the external public debt. Change in the internal-external public debt ratio was mainly due to the higher level of the debt of the National Bank on the basis of issued CB bills.

From the point of view of interest structure, changes were observed in respect to the total public debt. In fact, in the period January-September 2010, debt with variable interest rate increased by around 5 p.p., and the ratio between fixed interest rate debt and variable interest rate debt was 46:54 respectively. Increase of the variable interest rate debt was also a result of the increase of the debt of the National Bank. From the point of

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<sup>16</sup> Government debt is the sum of financial liabilities created by borrowing the Republic of Macedonia, here including the debt of the municipalities, the constituent municipalities in the City of Skopje and the City of Skopje itself.

<sup>17</sup> Public debt is the sum of all financial liabilities created by borrowing the Republic of Macedonia, here including the debt of the municipalities, the constituent municipalities in the city of Skopje and the City of Skopje, the debt of public enterprises and companies being fully or predominantly owned by the state or the municipalities, the constituent municipalities in the City of Skopje and the City itself, and the debt of the National Bank of the Republic of Macedonia



view of currency composition, debt denominated in foreign currency participated with 79%, and compared to the end of 2009, it decreased by 3.7 p.p.

**Table 3.5.** Stock of public debt

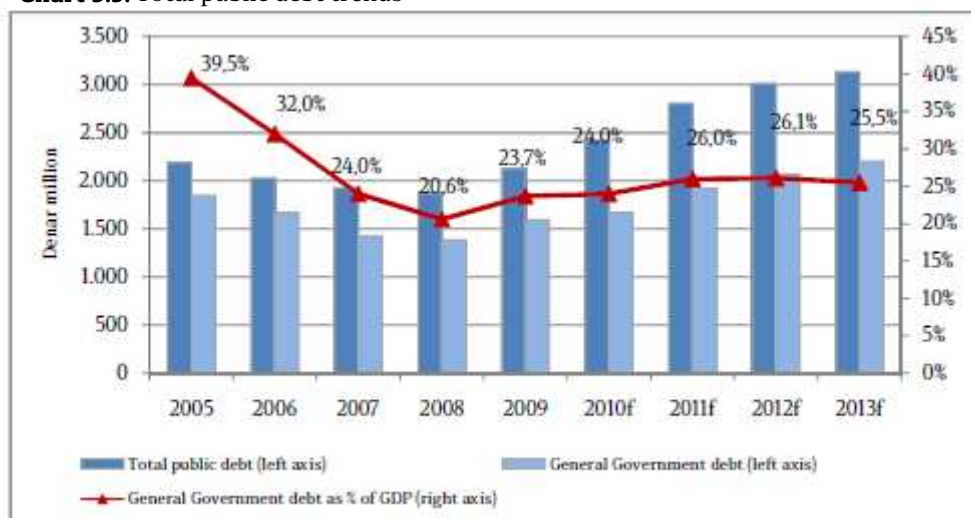
EUR million	2005	2006	2007	2008	2009	30.09.2010
<b>External public debt</b>	<b>1,441.2</b>	<b>1,223.0</b>	<b>1,027.9</b>	<b>1,115.7</b>	<b>1,373.8</b>	<b>1,442.4</b>
Government debt	1,245.4	1,025.2	877,2	921,2	1,105.3	1,144.6
Central Bank	52,7	42,4	0,0	0,0	71,7	75,0
Public enterprises	143,2	155,4	150,6	194,5	196,8	222,7
<b>Domestic public debt</b>	<b>750,4</b>	<b>806,5</b>	<b>899,9</b>	<b>754,5</b>	<b>755,0</b>	<b>950,8</b>
Government debt	603,7	648,4	552,8	465,9	492,0	506,3
Central Bank	146,7	155,3	344,3	285,2	260,4	433,0
Public enterprises	n/a	2,8	2,8	3,5	2,7	11,5
<b>Total public debt according to GFS Methodology and pursuant to Public Debt Law</b>	<b>2,191.6</b>	<b>2,029.5</b>	<b>1,927.8</b>	<b>1,870.2</b>	<b>2,128.8</b>	<b>2,393.1</b>
Total public debt as % of GDP	46.9	38.8	32.3	27.8	31.6	34.2
<b>Government debt</b>	<b>1,849.1</b>	<b>1,673.6</b>	<b>1,430</b>	<b>1,387.1</b>	<b>1,597.3</b>	<b>1,651.0</b>
Government debt as % of GDP	39.5	32.0	24.0	20.6	23.7	23.6

Source: Ministry of Finance and National Bank

In the period from 2010 to 2013 moderate growth in investment activity is projected through the use of credit support from abroad, without jeopardizing long-term sustainability of the level of indebtedness of the country, as well as the debt targets established in the Strategy for Public Debt Management. Such increase in the public debt level (see Chart 3.5) is mainly due to the new investments in the field of road and railway infrastructure, water-supply and sewerage network, sports facilities, construction of social flats, as well as investments in the field of education. In addition, higher level of investments in the energy sector is expected to be realized through borrowing by the public enterprises operating in the energy sector, by issuing sovereign guarantee. Issued sovereign guarantees are contingent liabilities for the Budget of the Republic of Macedonia (see Chart 3.6.), amounting to EUR 209,3 million as of 30<sup>th</sup> September 2010 inclusive, being 8.7% of the total public debt or only 3% of GDP. Compared to 2009, they increased by EUR 34.2 million or 0.5 p.p. in relation to the total public debt.



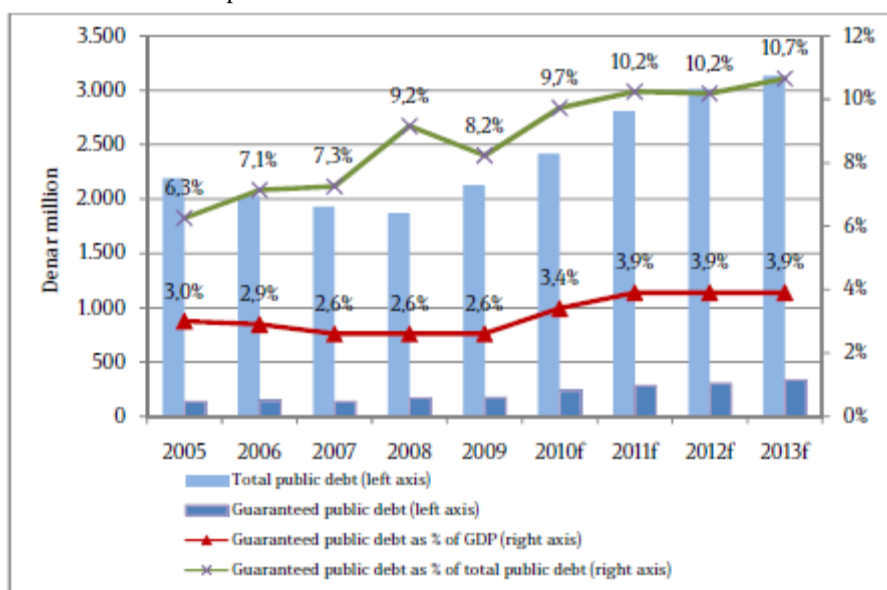
**Chart 3.5. Total public debt trends**



Source: Ministry of Finance and National Bank

\*Data for 2010 are definite for Q1, Q2 and Q3, while data for Q4 are forecasted.

**Chart 3.6. Guaranteed public debt**



Source: Ministry of Finance and National Bank

**Primary Government Securities Market.** During the first three quarters of 2010, total of twelve auctions of six-month treasury bills were carried out. Total offer at the auction amounted to Denar 21,712.55 million, the demand amounted to Denar 20,608.12 million, while realization reached Denar 20,391.09 million. As of the last auction in September 2010 inclusive, stock of undue government securities - GS (short-term and long-term) amounted to Denar 15,4 billion, i.e. EUR 249.89, Denar 15,1 billion out of as treasury bills, and the remaining as government bonds.

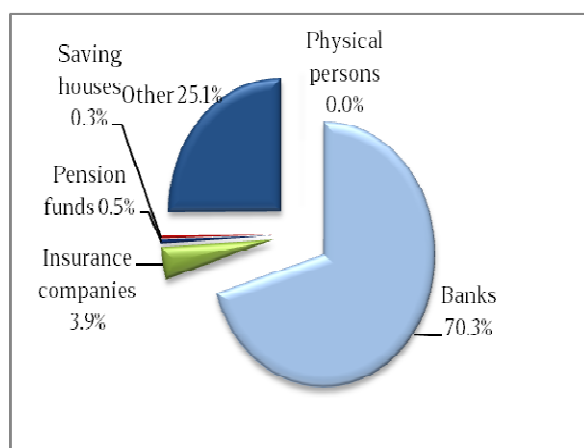


Downward trend of interest rates on government securities, which started in the second half of 2009, continued during 2010 as well. Interest rates on six-month treasury bills, with and without foreign currency clause were 4.40% and 4.70% at the auctions in September 2010 respectively, while on the last auction of six-month treasury bills carried out in 2009, with and without foreign currency clause, interest rates were 5.50% and 8.99%.

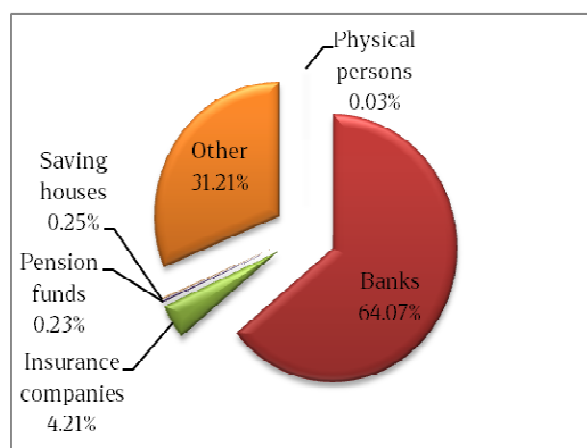
Commercial banks in the Republic of Macedonia continued to have the dominant share in the ownership structure of undue GS (see Chart 3.7). Compared to the end of 2009, as of the last auction in September 2010 inclusive, share of banks, Pension Funds and saving houses in the ownership structure of undue GS decreased, while share of insurance companies and category “*other*” increased.

**Chart 3.7.** Ownership structure of undue GS

Ownership structure of undue GS, 31.12.2009



Ownership structure of undue GS, 30.09.2010



Source: Ministry of Finance

**Secondary Government Securities Market.** Structural bonds (nine issues of government denationalization bonds, bonds for old foreign currency savings and bonds for selective credits), as well as continuous government bonds are traded on the Macedonian Stock Exchange. In the period January - September 2010, denatitonalisation bonds, as well as bonds for old foreign currency savings were traded. Total trading volume in this period amounted to EUR 13,39 million, and total trading turnover amounting to EUR 10.94 or Denar 694,04 million was realized.

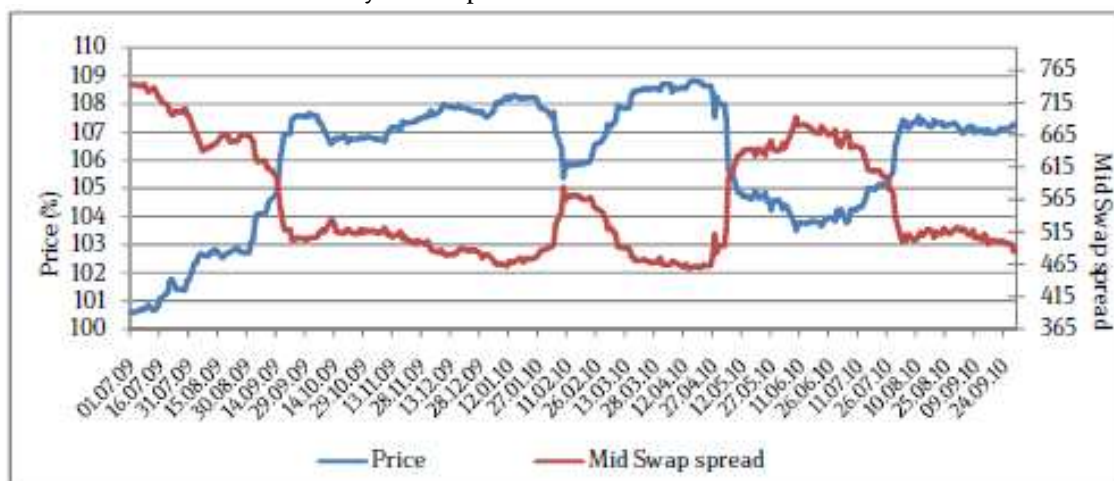
**International Capital Market.** Both Eurobonds issued by the Republic of Macedonia in 2005 and 2009 were traded on the international secondary capital market. In the period January-September 2010, the purchase price of the first Eurobond, falling due in 2015, ranged between 85.977 and 92.288 basic points, and the medium-term swap spread ranged between 571.888 and 378.474 basic points.





In the period January–September 2010, the purchase price of the second Eurobond, falling due in 2013, ranged between 103.516 and 108.821 basic points, and the medium-term swap ranged between 692.208 and 461.043 basic points.

**Chart3.8.** Eurobond issued by the Republic of Macedonia in 2009



Source: Ministry of Finance

**Credit Rating of the Republic of Macedonia.** In 2009, Credit Rating Agency Standard and Poor's rated the Republic of Macedonia's outlook as BB/stable outlook for foreign currency and BB+/stable outlook for local currency. As of October 2010 inclusive, Credit Rating Agency Fitch rated foreign and local currency as BB+, while the outlook of the country was revised to stable from negative compared to 2009. According to the report by Fitch from October 2010, improved credit rating of the Republic of Macedonia in 2010 is due to high fiscal discipline, stability of public finances, low public debt, and rebuilding foreign exchange reserves at a stable level.

## 3.2. Sensitivity Analysis

### 3.2.1. Sensitivity Analysis of the Budget Deficit

This section provides review of the results from the carried out sensitivity analysis of budget deficit. Namely, three pessimistic scenarios are being shown, assuming different conditions from those considered as the most realistic ones, i.e. from those conditions, taken as basis for medium-term projections (baseline scenario). Effects, i.e. sensitivity of budget deficit within the changed assumptions are analyzed under the three scenarios.

Baseline scenario, on which budget deficit projections are based envisages positive real GDP growth of 3.5% in 2011, intensifying to 4.5% and 5.5% respectively in 2012 and 2013 (See Section 2.2. medium-term macroeconomic scenario). Annual increase of budget revenues in 2011 is projected at 6.6%, slowing down in 2012 and 2013 to 5.2% and 5.8%



respectively. Trend of budget expenditures envisages 6.9% increase in 2011, 4.3% in 2012 and 5% in 2013. Under these assumptions, budget deficit is expected to account for 2.5% of GDP in 2011, and it is envisaged to drop to 2.2% and 1.9% of GDP in 2012 and 2013 respectively.

As *first scenario*, we assume reduced GDP real growth dynamics in 2011 and 2012, as a result of the realization of certain downward risks, such as slower recovery of the EU economy, i.e. of the main trading partners of the Republic of Macedonia, or as a result of

**Table 3.6.** Sensitivity Analysis of the Budget Deficit

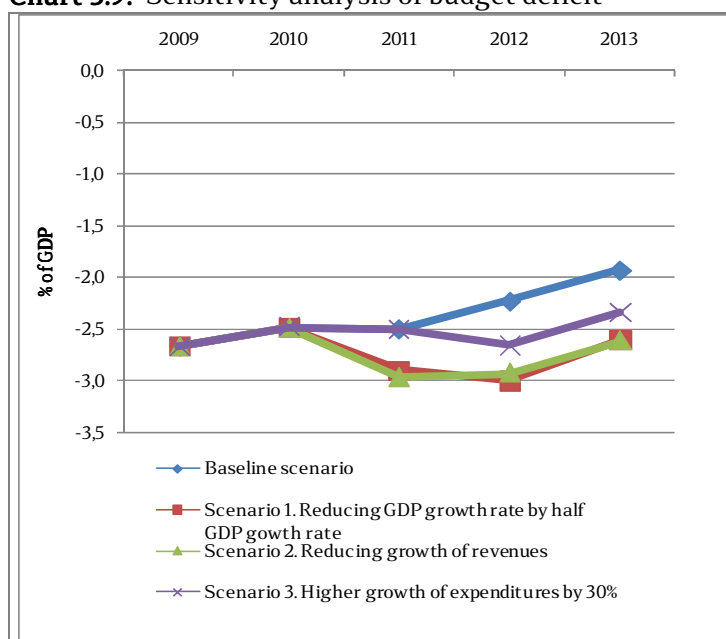
	2009	2010	2011	2012	2013
GDP, real growth rate	-0.9	2.0	3.5	4.5	5.5
Budget revenues, growth rate	-5.8	7.9	6.6	5.2	5.8
Budget expenditures, growth rate	-0.6	7.0	6.9	4.3	5.0
<b>Budget Deficit</b>					
Baseline scenario	-2.7	-2.5	-2.5	-2.2	-1.9
Scenario 1. Reducing GDP growth rate by half	-2.7	-2.5	-2.9	-3.0	-2.6
Scenario 2. Reducing growth of revenues	-2.7	-2.5	-3.0	-2.9	-2.6
Scenario 3. Higher growth of expenditures by 30%	-2.7	-2.5	-2.5	-2.6	-2.3

Source: Calculations of the Ministry of Finance

the lower level of investments, due to the sustainable uncertainty and reservation on the investor side. In fact, we assume GDP real growth rates in 2011 and 2012 to reduce by half, i.e. instead of 3.5% and 4.5%, to amount to 1.75% and 2.25%, respectively. Under such assumptions, sensitivity analysis shows deepening of budget deficit in the next three years to 2.9% in 2011, 3.0% in 2012 and 2.6% in 2013, compared to the initial projections of 2.5%, 2.2% and 1.9%, respectively. Hence, it can be noticed that even under such deteriorated conditions, budget deficit would not exceed Maastricht criteria of 3%.

Under the *second scenario*, we assume for budget revenues growth to reduce by 20%, compared to the initially the envisaged revenues for both 2011 and 2012, which could be result of the reduced spending by economic entities. In fact, under such assumptions, budget deficit would increase by 0.5 p.p., 0.7 p.p. and 0.7 p.p.,

**Chart 3.9.** Sensitivity analysis of budget deficit



Source: Calculations of the Ministry of Finance

respectively compared to the baseline scenario and it would reach 3.0%, 2.9% and 2.6% in the three subsequent years. Maastricht criteria of 3% is again not exceeded.

As for the *third* scenario, we assume one-off shock, i.e. 30% higher growth of budget expenditures than the projected one for 2012, which could be a result of the increase of salaries and number of employed civil servants or similar. Sensitivity of budget deficit to this variable is relatively lower. In fact, under such assumption, budget deficit increases by 0.4 p.p. in 2012 and 2013 compared to the initial projections, reaching 2.6% and 2.3% respectively.

If any of the given scenarios occur, the Government will appropriately respond by lowering the consumption to a level necessary to maintain the planned budget deficit. Additionally, for smooth financing of the budgetary needs, a PCL credit line from the IMF is available to the Republic of Macedonia. PCL is a new credit instrument designed for countries with sound economic policies which currently do not require funding, but in an environment with risks still present they might find themselves in a position of additional budgetary support. The credit line ensures that if there is a negative developments in the economy, there will be sufficient funds which can be withdrawn in order to preserve stability. In addition, this possibility contributes to strengthen investor confidence and easier access to funds on the capital markets.

### 3.2.2. Analysis of the sensitivity of public debt

**Public Debt Risks.** Uncertainty arising from future trends of macroeconomic variables on the international and the domestic capital market significantly influences the decision - making process as regards efficient management of the debt portfolio of the country. In conditions of large oscillations of economic variables, need arises to actively manage risks to which public debt portfolio of the Republic of Macedonia is exposed.

Main risks, identified when managing this portfolio are the following:

- refinancing risk;
- market risk including the following risks:
  - a) interest rate risk;*
  - b) exchange rate risk;*
- liquidity risk;
- risk associated with contingent liabilities and
- operational risk.

**Public Debt Sensitivity.** In order to examine sensitivity of public debt portfolio of the Republic of Macedonia to exposure to market risk i.e. interest rate risk and exchange rate risk, analysis was made of the influence of the variation of interest rates and exchange rate over the general government external debt.



Taking into consideration the developments in interest-related costs in the Budget of the Republic of Macedonia on the basis of external debt, the public debt sensitivity analysis is based upon the following assumptions:

- according to the change of one variable, all other variables remain unchanged, i.e. ceteris paribus;
- during possible trends in the other currencies in relation to the euro, Denar exchange rate in relation to the euro retains the stable value; and
- non-existence of correlation between interest trends and trends in the foreign exchange rate.

**Table 3.7.** Index of interest costs on the basis of external public debt in the Budget of the Republic of Macedonia, when interest rates or foreign exchange rates change

	2011	2012	2013
<b>Baseline scenario</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Scenario 1 (+0.5% interest rate)	105.0	104.0	103.9
Scenario 2 (+1% interest rate)	110.0	108.0	107.8
Scenario 3 (appreciation of euro in relation to other currencies by 10%)	99.0	99.3	99.4
Scenario 4 (depreciation of euro in relation to other currencies by 10%)	101.2	100.8	100.7

*Source:* Calculations of the Ministry of Finance

Main conclusions of this analysis are the following:

- servicing-related costs on the basis of the general government external debt are sensitive to trends in the interest rates. If the interest rates increase by only 0.5 p.p. in 2010, it would cause increase of the servicing-related costs by 5%. This sensitivity may be explained as a result of the exposure of debt portfolio to interest rate risk, being a result of the share of the debt with variable interest rates; and
- future appreciation/depreciation of the euro in relation to other currencies in the portfolio (the American dollar, the Japanese Yen and the Special Drawing Rights) by 10% will cause decrease/increase of the servicing-related costs due to the de facto exchange rate regime of the domestic currency in relation to the euro. However, the possible unfavorable trends in the foreign exchange rates of other currencies in relation to the euro will not be strongly felt over the servicing-related costs, due to the fact that the major portion of the general government external debt is denominated in euro currency.

### 3.3. Quality of public finances

During 2010 and in the coming medium-term period as well, policies will be focused on improving quality of public finance on both the revenue and the expenditure side. Republic of Macedonia successfully coped with the consequences from the global



economic crisis, generally as a result of the adequate institutional and legal framework and the effects from the anti-crisis measures the Government undertook. In July 2010, Supplementary Budget was adopted, thus respectively adjusting the budget projections and implementing the adopted austerity measures. In the post-crisis period, public expenditures still remain to be quite important instrument in increasing the potential development and are mainly used as intervention instrument to increase both production and demand.

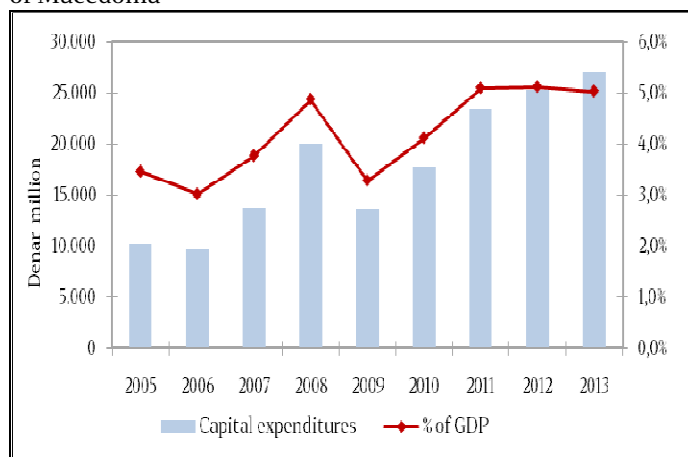
In addition, during 2010, as well as in the next medium-term period, structural improvement of the expenditure side of the Budget is expected, by significantly increasing the share of capital investments on one hand, and more controlled and restrictive usage of less productive expenditures on the other. Thereby, in line with the priority sectoral policies, capital investments for construction of road and railway infrastructure significantly increased, which will have positive effects on the recovery of economic activity and quality of life. At the same time, increased subsidies in the field of agriculture and credit lines for SMEs for starting new businesses, with low interest rates, will provide for job creation and adequate impulse on the economic development.

In the next medium-term period, increased efficiency of using budget funds is expected to contribute to improving services in the field of social protection, health, education and infrastructure.

### 3.4. Budgetary Implications of the “Major Structural Reforms”

Public finances in the coming mid-term period are designed to support the structural reform agenda of the country, as further elaborated in Part 4 of the Programme. In line with the Accession Partnership priorities, the structural reform agenda of the Government is aimed at enhancing the attractiveness of the country for foreign and domestic investors and increasing the level of investments, decreasing of the unemployment, further support to SMEs, improving education quality, rule of law, improving the quality of public services to citizens, strengthening fiscal capacity of the municipalities, strengthening of the supervisory activities of the agencies, increasing agricultural productivity, increasing the capacity of the public administration in implementing reforms, etc.

**Chart 3.10.** Capital expenditures of the Budget of the Republic of Macedonia



Source: Ministry of Finance





Two major reforms envisaged for the coming three-year period is the creation of two new institutions, i.e. merging the activities of the current Veterinary Directorate and Food Safety Directorate into a new Food and Veterinary Agency, as well as expansion of the activities of one of the existing authorities, the Ministry of Information Society into a Ministry of Information Society and Public Administration. However, no budgetary implications are envisaged in the initial period since the reforms include merging of the activities of separate institutions into a new authority.

As elaborated earlier, efforts have been put on increasing the quality of public finances while ensuring the macroeconomic stability through keeping low budget deficit and prudent public debt management, which are considered as main pre-requisites for enhancing the functioning of the market economy making it able of dealing with the competitive forces following the entry in the EU.

### 3.5. Sustainability of Public Finances

Analysis of long-term sustainability of public finance is based on the following long-term assumptions:

- GDP growth in the following forty years by around 4% on average;
- stable productivity growth by around 2%;
- small increase of male participation rate (from 76.8% in 2010 to 86.3% in 2050);
- higher increase of female participation rate (from 50.3% in 2010 to 67.3% in 2050), with a proportion of women active population increasing to 44% in the last decade of the analyzed period;
- strong decline in the unemployment rate in the first twenty years (from 32.1% to 16.3%) and a certain stabilization in the next twenty years with unemployment rate projected at 12% in 2050; and
- steady growth of the share of population aged 65+, reaching 13% by the end of 2050.

It is also assumed that there will be no further changes in the regulations. In addition, it is assumed that non-tax budget revenues as percentage of GDP will not change, as well as some of the items on the expenditure side.

On the basis of the above mentioned assumptions, as well as projections for increase in employment and wages, a moderated increase of the share of revenues from pension insurance contributions is estimated in 2020, amounting to 6.4% of GDP. However, the share of pension contributions is expected to stabilize at the level of about 6.5% in the period after 2020. Pension expenditures, having the highest share amongst the observed expenditure items, are expected to retain the current share to GDP (8.8%) in the next ten years, and an increase by 0.2 percentage points of the share is envisaged thereafter up to 2040. It is worth noting that pension expenditures include only the ones of the State





Pension Fund, rather than the expenditures of the private pension insurance funds (whether mandatory or voluntary pension insurance). Thus, it is expected to gradually decrease the share of those pensioners whose pensions are entirely paid from the first pillar, and the growing share of those, who will receive part of their pensions from the first pillar and the other part from the second pillar. Taking this that into consideration, a slight decline of the share of pension expenditures is expected in the last ten years of the analyzed period.

Public expenditures in the health care system as percentage of GDP are projected to increase from 4.5% in 2010 to 5% by 2030, and stabilizing thereafter. Such relatively stable increase of expenditures for health care in line with the GDP growth is a result of the estimated effect of aging population and increased health care expenditures in line with the productivity growth. As for the expenditures for education, it is envisaged for them to gradually increase as percentage of GDP from 4.6% in 2010 to 5.2% in 2050, regarding their importance for restructuring of the labor market, reducing unemployment rate and therefore contributing for higher economic growth.

The share of interest expenses to GDP, given the projected budget deficit and its financing, is expected to grow from 0.7% in 2010 to 0.9% in 2020 and further to 1% in 2030, which is projected remain on that level by the end of 2050.

### 3.6. Institutional Features of Public Finance

Improvement of quality of public finance will be underpinned with adequate modifications in the existing legal regulations and respective improvement of the institutional and the administrative structure, as result of which activities will be implemented in the coming medium-term period, aimed at:

- developing and enhancing the process of multi-annual budgeting, especially focusing on the development programmes, with indicative projections for the next two years and possibility for transfer of appropriations for financing capital projects and projects financed under pre-accession funds from one into another fiscal year. These activities will be supported within a project financed with resources from IPA funds;
- increasing budget process transparency, by extending the time frame for Budget preparation and simultaneous inclusion of NGOs, experts and business community in the Budget preparation itself;
- further harmonizing and applying the International Accountings Standards; and
- strengthening fiscal capacity of local government units and providing possibility for their borrowing.

**Introduction of ESA 95 Methodology.** State Statistical Office, Ministry of Finance and National Bank are part of IPA Programme 2007 titled "*Technical Assistance for the State Statistical Office*". The Programme was launched in 2010 and it will last two years, i.e. by

2012. State Statistical Office is main coordinator and beneficiary of the Programme, while Ministry of Finance participates in the section referring to the statistics of the national accounts. Goal of the Programme is to contribute to improving the overall system for generation of quality statistical data of the State Statistical Office, as well as further development of national statistical system towards fully sustainable and harmonized with the European statistical system.

Ministry of Finance is included in the second component for further harmonization of the national accounts with the European System of Accounts (ESA 95 Methodology), as regards the statistics of the Government account and the fiscal notifications. So far, Ministry of Finance has participated in trainings and seminars related to these issues, having active cooperation with the State Statistical Office as regards methodology, data availability, etc.

**Budget Transparency.** Pursuant to the Budget Law and to the end of full transparency, Reports on the Execution of the Budget of the Republic of Macedonia are published on the internet site of the Ministry of Finance on monthly basis. In addition, Minister of Finance submits Report on the execution of the Budget of the Republic of the first six months to the Government of the Republic of Macedonia by 31<sup>st</sup> July in the fiscal year, accompanied by updated report on macroeconomic indicators and projected revenues, as well as assumed liabilities and expenditures in the fiscal year. In favor of greater transparency, the Budget of the Republic of Macedonia and the annual statement, are published in Official Gazette of the Republic of Macedonia, while budgets of municipalities and annual statements are published in the Official Gazette of municipalities.

**Public Internal Financial Control (PIFC).** The process of strengthening financial control in the public sector in the Republic of Macedonia is being implemented through the development and application of decentralized management and responsibility of a independent internal audit and development of all three components of the PIFC: financial management and control, internal audit and their harmonization. The objective of this process is building a system that will ensure reasonable use of budgetary funds by introduction of sound financial management.

In order to improve the legal framework in the area of PIFC a the Law on State Audit Rules and 9 rulebooks which closely regulates PIFC were adopted during 2010. In addition, a 2010 - 2012 Strategy for PIFC was adopted in June 2010.

In the following mid-term period, in order to further strengthen PIFC, additional necessary measures will be implemented so to increase the capacity of the units for financial affairs and internal audit units and the capacities of the Central Harmonization Unit in the Ministry of finance. Strengthening of internal control, among other things, will be realized through the establishment of the Committee on Financial Management and Control and Audit Committee in the Ministry of Finance. In order to prevent

irregularities, fraud or corruption, financial inspection in the public sector will be introduced. The establishment and development of a comprehensive and effective system of PIFC is part of the reform of public administration in the Republic of Macedonia.

**Measures in the Field of using EU Funds.** New Law on IPA Audit was adopted in May 2010. Adoption of this Law regulates the operations of the Audit Authority as body, responsible to the Government of the Republic of Macedonia. The Law provides legal framework for audit of IPA as precondition for full IPA implementation, manner of auditing, organizational setup, competence, subject to audit, authorizations and responsibilities of the Audit Authority as an autonomous and independent legal entity which should be functionally independent from all participants in IPA management and control systems.

During 2010, the Audit Authority continued with realization of the activities necessary for auditing the IPA system in the Republic of Macedonia, by further strengthening institutional capacities, ensuring adequate working conditions and continuous education and advanced training of employees in the Audit Authority. In the period 2011–2013, manuals for IPA audit will be revised and updated, and other methodological guidelines on auditing under the competence of the Audit Authority will be also prepared.



## PART IV

# Structural Reforms



Current macroeconomic climate and external risks force to acceleration of the process of implementation of Copenhagen Criteria and the priorities under the Accession Partnership, in order to enhance competitiveness of the Macedonian economy. Hence, commitment of the Government of the Republic of Macedonia to implementing structural reforms will continue in the coming three-year period as well. Expectations are that their implementation will contribute to enhance the functioning of the market economy by strengthening the relations between the supply and the demand on the labor market, improving the business climate, improving the effectiveness of the services to citizens, further improvement of the property rights, cadastre reforms to improve records of property rights, effective rule of law and execution of contracts, improving transport and energy infrastructure, supporting SMEs, strengthening fiscal capacity of municipalities, strengthening supervisory activities of regulatory bodies, strengthening productivity in agriculture and reducing the participation of the state in the private sector by rounding-up the privatization process.

#### 4.1. Sector of the enterprises

**Industrial Policy.** Pursuant to the Accession Partnership priorities, a Strategic document titled *“Industrial policy of the Republic of Macedonia 2009-2020”* was adopted, which promotes integrated and proactive approach for increasing of the competitiveness of the economy. The document defines several areas of intervention that are expected to contribute towards increasing the competitiveness of the industry such as: increase of the international cooperation and incentives for FDI, applicable research, development and innovations, eco-technologies, products and services for sustainable development, development and support of SMEs and entrepreneurship, as well as cooperation in clusters and networks.

A Program for support and development of the cluster associations is currently in the process of realization. The activities in this Program are expected to contribute towards improving the competitiveness and export. Mainly, these activities include: better promotion of the manual for cluster association and the advantages of the cluster membership, training and upgrading of the management of the clusters, better networking of the clusters, in addition to initiatives for establishment of new clusters. The Government support provided through public – private dialogue is expected to contribute for creation of new cluster initiatives, as well as, self-sustainability of the clusters based on innovations. Beside the existing 10 clusters, three new clusters were established. ICT cluster as the most developed cluster recently prepared Strategy for export promotion of the software and IT- service industry. It seems important to note that during 2010, the institutional infrastructure in the area of the industrial policy is strengthened in the part of the export promotion through widening of the jurisdiction of the Agency for foreign investments with export promotion.



In order to further improve the business climate, making it favorable for doing business and attractive for FDIs, there are ongoing activities for preparation of the Program for investment stimulation (2011-2014) and Strategy for export promotion.

In the following mid-term period, the activities defined in the Strategic document *“Industrial Policy of the Republic of Macedonia 2009-2020”* will continue. At the same time, regular monitoring of the indicators for competitiveness and regular preparation of comparative analysis of the economy competitiveness with other countries in the EU and the region, are expected to provide insight for additional measures and activities which need to be implemented in order to enhance the competitiveness of the economy.

Matrix of budget implications (in Denar million)

Description of policy	2010	2011	2012	2013
<b>1. Program for implementation of the industrial policy 2009-2020</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	11,820,000	23,938,594	24,216,594
B.1 Direct effect on budgetary revenues	--	0	77,549,346	77,549,346
B.2 Direct effect on budgetary expenditures	--	11,820,000	101,487,940	101,765,940
<b>2. Program for development of clusters</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	3,000,000	3,600,000	4,900,000
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	3,000,000	3,600,000	4,900,000
<b>Total net budgetary effect</b>				
Total effects on budget revenues	--	0	77,549,346	77,549,346
Total effects on budgetary expenditure	--	14,820,000	105,087,940	106,665,940

\* The beginning and if necessary, end of the implementation marked with the symbol “X”

**Small and medium-sized enterprises.** SMEs are the dominant type of enterprises in the Macedonian economy, covering more than 90% of the total number of the existing enterprises. Taking this into account, SMEs significantly contribute in the creation of GDP. Furthermore, SMEs absorb the largest part of the working force (79%), while at the same time contributing in the reduction of the unemployment. In 2009, their number amounted to 61,262<sup>18</sup>, while newly registered companies increased by 1,566 when compared to 2008. Number of craftsmen amounted 1,888<sup>19</sup> which is an increase of 194, as compared to 2008.

The activities for development of SMEs are defined in the National strategy for development of SMEs (2002-2013). The implementation of the activities defined in this Strategy, is in-line with the priorities of the Accession Partnership. The support for SMEs development in 2010 was implemented through: assistance to SMEs for

<sup>18</sup> Last available data from the Central registry of the Republic of Macedonia.

<sup>19</sup> Ibid.





implementation of standards, promotion of their products, internationalization of their businesses, easier access to the EU funds, co-financing of the SMEs for training or implementation of ISO, NASSR and SA 8000 standards; co-financing of the expenses for industrial design development, application of patents, financing of the program activities of EIICM; realization of the Projects titled “*Entrepreneurship in the higher education*” and “*Building capacities for creation of economy based on knowledge*”.

Special attention is paid to entrepreneurship promotion. Each year, events such as: ‘European Entrepreneurship Week’, ‘Global Entrepreneurship Week’ and ‘Selection of Entrepreneur of the Year’ are being organized. These events are organized by several organizations (economy chambers and civil organizations) working in the field of SMEs development. Since 2008 started to implement the Global Entrepreneurship Monitor–GEM), as the largest entrepreneurship research in the world. According to the latest research data conducted in 2010, perception for entrepreneurship in the Republic of Macedonia are largely positive.

When it comes to support of SMEs as large contributors to the overall economy and GDP creation, it seems important to note that on the 25<sup>th</sup> of June 2009, a Financial Loan Agreement between the EIB and the Macedonian Bank for Development Promotion (MBDP) amounting to EUR 100 million and a Guarantee Agreement between the EIB and the Republic of Macedonia for funding SMEs project and other priority projects was signed. This project is one of the anti-crisis measures that the Government has implemented in order to provide fresh capital and mitigate the consequences of the global economic and financial crisis on the real sector. So far, seven disbursements are committed in the amount of nearly EUR 70 million, while the total amount of the loan is expected to be disbursed by mid-2011. According to the analysis of the MBDP, nearly 2,000 new jobs are expected to be created, implying that this credit line contributes towards improvement of the labor market as well.

By the end of 2010, the following development documents are being envisaged:

- new Program which will define the measures and activities for further support of SMEs and development of the entrepreneurship, competitiveness and innovation for the period 2011-2013;
- Strategy for crafts development;
- Following the EU example, European innovation plate (EIP) for the Republic of Macedonia will be prepared by the end of 2010, which is considered as a final result of the Project titled “*International technical assistance for implementation of the EIP for the Republic of Macedonia*”.

In the period 2011-2013, following the recommendations from 2010 EC Progress report, the activities foreseen will aim at strengthening of the institutional infrastructure, improvement of the business environment and improvement of the competitiveness and innovativeness. Based on the principles of the Act for small businesses, appropriate measures for realization of these goals will be defined in the new three year program.



Additionally, as a result of the vast interest for using the funds from the ongoing credit line for support of the SMEs from the EIB, during 2011 the Government of the Republic of Macedonia will initiate negotiations with the EIB for additional EUR 100 million for further SMEs support and priority projects proposed by municipalities.

**Matrix of budget implications (in Denar million)**

Description of policy	2010	2011	2012	2013
<b>1. National program for improvement of the entrepreneurship and competitiveness of the small and medium enterprises in the Republic of Macedonia</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	3,385,091	12,309,420	12,309,420
B.1 Direct effect on budgetary revenues	--	9,232,065	5,169,956	0
B.2 Direct effect on budgetary expenditures	--	12,617,156	17,479,376	12,309,420
<b>2. National strategy for development of the crafts</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	984,754	3,077,355	9,232,065
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	984,754	3,077,355	9,232,065
<b>3. European Innovation Plate for the Republic of Macedonia</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	0	6,154,710	6,154,710
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	0	6,154,710	6,154,710
<b>Total net budgetary effect</b>				
Total effects on budget revenues	--	9,232,065	5,169,956	0
Total effects on budgetary expenditure	--	13,601,910	26,711,441	27,696,195

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

**Privatization.** There are 68 legal entities in complete or partial state ownership. Public Call for sale of the state ownership share in the companies "EMO AD Ohrid", "Tobacco Combine AD Prilep" and "Eurokompozit AD Prilep" were published on the 20<sup>th</sup> of May 2010, while the public call for sale of state ownership share in the company "OHIS AD Skopje" was published on September 17<sup>th</sup> 2010. If the bids are unsuccessful, there is a possibility for the procedure for sale to be repeated during the next period. In addition, decisions based on previously made analysis which of the state shares will be offered for sale will be adopted during 2011.



**Table 4.1.** Data for the companies in partial or complete state ownership

Companies with complete or partial state ownership	68
Companies in complete state ownership (Macedonian Post AD, Macedonian Bank for development support, ELEM, MEPSO, MIA, 11 October Eurokompozit AD Prilep, TPP Negotino, Energetika AD Skopje, Agri land Skopje, State Lottery of Macedonia, M-HAB AD Skopje, Company for airport services and airports of Macedonia Skopje)	12
Companies with participation of the state below 1% of the shareholders capital	17
Companies with participation of the state between 1% and 10% of the shareholders capital	20
Nominal value of the state capital	EUR 936,8 million
State capital, as percent of GDP	13.35%
State capital in the five companies with largest participation of the state (ELEM, T-Home, AD MEPSO, Tobacco Combine AD Prilep and OHIS AD Skopje)	EUR 735,7 million
Participation of the state capital in GDP in the five companies with largest state participation (ELEM, T-Home (34%), AD MEPSO, Tobacco Combine AD Prilep and OHIS AD Skopje)	10.48 %
Participation of the state capital in GDP in the remaining 63 companies	2.87 %

Source: Ministry of Economy

**Competition and state aid.** The new Law on Protection of Competition has been enacted in October 2010. The most important changes in this Law are related to conducting of procedures and the introduction of leniency. Namely, the changes include direct conducting of misdemeanor procedures in which the infringement of the Law on Protection of Competition will be determined and fine will be imposed.

In addition, a new Law on State Aid Control was enacted in October 2010, which regulates in detail the procedures for assessment of state aid by the Commission for Protection of Competition, while stipulating explicitly the application of the Law on General Administrative Procedure.

It is important to emphasize that these laws are fully compatible with the EU competition legislation. It is expected that the new Laws on Protection of Competition and State Aid Control will increase the efficiency in their implementation, taking into consideration that the period for conducting procedures has been shortened. It is expected that the new Law on State Aid Control will achieve an effective ex-ante control of state aid.

During 2010, the inter-institutional and international cooperation has been strengthened. Namely, the Commission has signed a Memorandum for cooperation with the Commission for Competition of Kosovo. Apart from this Memorandum, the Commission had signed Memorandums for cooperation with the Public Procurement Bureau and the competition authorities from the countries in the region, i.e. Croatia, Bosnia and Herzegovina, Albania, Serbia and Bulgaria.



Besides the implementation of the newly adopted Laws on Protection of Competition and State Aid Control, the following activities are envisaged for the period 2011 – 2013:

1. enactment of the bylaws deriving from the new laws;
2. further strengthening of the administrative capacity of the Commission for Protection of Competition through the project titled “*Assistance to the Commission for Protection of Competition for state aid control*” which is envisaged to be financed through the 2009 IPA (TAIB) Program. The project is expected to last 18 months starting from September 2011.

**Matrix of budget implications (in Denar million)**

Description of policy	2010	2011	2012	2013
<b>1. Assistance to the Commission for Protection of Competition for state aid control</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	1,025,785	1,025,785	1,025,785
B.1 Direct effect on budgetary revenues	--	31,183,823	21,438,948	5,846,975
B.2 Direct effect on budgetary expenditures	--	32,209,608	22,464,733	6,872,760
<b>Total net budgetary effect</b>				
Total effects on budget revenues	--	31,183,823	21,438,948	5,846,975
Total effects on budgetary expenditure	--	32,209,608	22,464,733	6,872,760

\* The beginning and if necessary, end of the implementation marked with the symbol “X”

**Energy sector.** During 2010, the Government adopted the following three significant strategic documents: a) Strategy for energy development - 2030, b) Strategy for utilization of the renewable energy sources -2020, and c) Strategy for energy efficiency - 2020. The preparation of Program and Action plans for the stated strategies will follow in the next period.

By the end of January 2011, the new Energy Law is expected to be adopted by the Parliament. This Law is prepared pursuant to SAA obligation for harmonization of the legislation with the EU and based on the Treaty establishing the Energy Community. The preparation of the Energy Law is pursuant to the NPAA and the Accession Partnership.<sup>20</sup>

The new Energy Law regulates more precisely the jurisdictions of the Energy Regulatory Commission, adding towards strengthening of its independence, while it also defines the regulations referring to third party access to the energy networks. In addition, the new Law includes the aspects that refer to the cross-border exchange of energy and granting and use of the cross-border transmission capacities, precision of the criteria and

<sup>20</sup> To continue with the harmonization of the legislation for the internal markets of electricity and gas, energy efficiency and renewable energy sources with the Acquis, with purpose of gradual opening of the energy market for the competition; to continue the strengthening of the Energy Regulatory Commission; to fulfill the obligations that result from the Energy Community Treaty for the internal market of natural gas and electricity and the cross-border exchange of electricity.

liabilities for public service, quality of energy supply, protection of the final consumers of energy and opening of the energy markets.

With a purpose to create stable regulatory framework for attraction of investments in the energy sector, the adoption of the Energy Law will be followed by intensive activities for preparation of the subsequent by-laws which will define the market rules, tariff systems, methodologies for setting the prices, grid codes, rules of supply and others. These activities will meet the remarks of 2010 EC Progress Report in the energy related part.

During the past period, the Program for small hydro power plants was successfully implemented. 35 Agreements for concession for 35 small HPPs with installed capacity of 21 MW were signed and by the end of 2010, it is expected that 13 more Agreements for concession will be signed. Taking into consideration that there is possibility for construction of larger number of small HPPs, the activities for granting of concession for water will continue in the following mid-term period.

In the period 2011-2013, procedure for granting concession for water for generation of electricity from the HPPs “*Chebren*” and “*Galishte*” on the river Crna is envisaged to be conducted, as well as preparation of the necessary documentation for implementation of the project for construction of HPPs on the river Vardar.

In the period 2011 – 2013, the construction of 400 kV transmission line “*Macedonia-Serbia*” is envisaged to begin. In addition, the entire technical documentation for the interconnection lines with Albania and Kosovo is envisaged to be completed in order to connect the power system of the Republic of Macedonia with the power systems from the neighboring countries.





Matrix of budget implications (in denar million)

Description of policy	2010	2011	2012	2013
<b>1. Implementation of the Strategy for improving the energy efficiency in Republic of Macedonia until 2020</b>				
A. Implementation profile*	X			
B. Net direct budgetary effects (if any)	3,138,902	861,659	3,077,355	1,538,678
B.1 Direct effect on budgetary revenues	7,385,652	123,094,200	92,320,650	123,094,200
B.2 Direct effect on budgetary expenditures	10,524,554	123,955,859	95,398,005	124,632,878
<b>2. Preparation of the Strategy for energy development in Republic of Macedonia until 2030</b>				
A. Implementation profile*	X			
B. Net direct budgetary effects (if any)	7,080,000	--	--	--
B.1 Direct effect on budgetary revenues	0	--	--	--
B.2 Direct effect on budgetary expenditures	7,080,000	--	--	--
<b>3. Preparation of the Strategy for using renewable sources of energy in Republic of Macedonia until 2020</b>				
A. Implementation profile*	X			
B. Net direct budgetary effects (if any)	712,080	--	--	--
B.1 Direct effect on budgetary revenues	0	--	--	--
B.2 Direct effect on budgetary expenditures	712,080	--	--	--
<b>4. Implementation of the Strategy for using renewable sources of energy in Republic of Macedonia until 2020</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	6,000,000	--	--
B.1 Direct effect on budgetary revenues	--	0	--	--
B.2 Direct effect on budgetary expenditures	--	6,000,000	--	--
<b>Total net budgetary effect</b>				
Total effects on budget revenues	7,385,652	123,094,200	92,320,650	123,094,200
Total effects on budgetary expenditure	18,316,634	129,955,859	95,398,005	124,632,878

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

## 4.2. Financial system

**Banking Sector.** During 2010, in line with the EC recommendations the following activities in the banking sector were undertaken:

- Law on Financial Companies was adopted, governing the establishment, operating and supervision of non-banking financial institutions which carry out crediting and factoring and issuing guarantees. These new companies will contribute to developing market competition and facilitating access to credits for SMEs;
- The Law on Deposit Insurance Fund was amended, thus being harmonized with the Acquis Communautaire, as regards to the amount of insured deposits and the payment period. This will contribute to higher security of the deposits and will increase the deposit potential of banks;





- Law on the National Bank of the Republic of Macedonia was adopted, being harmonized with the Protocol on the Statute of the European System of Central Banks and of the European Central Bank (1992);
- Law on Distance Selling of Financial Services was adopted, thus harmonizing the national legislation with Directive 65/2002/EC, providing the consumers from the Republic of Macedonia with non-discriminatory access to financial services and freedom of choice on the single market, applying equal terms as the consumers from the Member States;
- for the purpose of efficient coordination and adequate readiness for crisis planning and dealing with financial crisis, Ministry of Finance and National Bank, as institutions competent and in charge of preserving stability of the financial system, signed Memorandum of Understanding.

In the period 2011 – 2013, in line with the recommendations of the Basel Committee on Banking Supervision and the Committee of European Banking Supervisors, referring to harmonization of the implementation of the New Basel Capital Accord and in line with the features and the capacities of the banking system and banking supervision in the country, the National Bank will gradually move towards the New Basel Capital Accord.

The regulative framework for introduction of the standardized approach for determining the minimum capital requirement will be completed by mid-2011 by adopting the regulations on determining the minimum capital requirements for credit risk coverage (regulations on determining the minimum capital requirement for covering operational risk was adopted in February 2009). Their application will begin on December 31<sup>st</sup> 2011. According to the current methodology on capital adequacy, minimum capital requirement for the market risk is already being calculated in line with the standardized approach. This will provide for gradual shift from standardized to advanced approach for determining the minimum capital requirement. The preparation of the regulations on advanced approach will start in 2013, while the preparation of the plan for administrative and technical preconditions necessary for preparation of these regulations is ongoing.

Application of the *Second Pillar* has already commenced by implementing the new methodology on risk-based supervision (transition has been gradually implemented, starting 2006), establishing and implementing improved risk management principles, as well as by obligating the banks to establish internal processes of assessing capital adequacy. In addition, with the Banking Law and respective bylaws, inclusion of all operational risks to which banks are exposed, when determining capital adequacy is required rather than just the risks explicitly listed in the methodology for determining capital adequacy. Application of the *Third Pillar* commenced with the banks adopting the regulations on data publishing.

In line with EC recommendations from the 2010 Progress Report, particular accent, as regards structural reforms in the banking sector in the period 2011 – 2013, will be put on:

- adoption of the Law on Financial Conglomerates, establishing rules for additional



- supervision of banks, insurance companies, re-insurance companies, brokerage houses and investment fund management companies when they are part of a financial conglomerate;
- modifying the Banking Law which will lead to further harmonization with the banking directive as regards cross-border provision of services;
  - amending the Consumer Protection Law with respect to consumer credit contracts, which will contribute to more efficient protection, knowledge and education of credit beneficiaries.
  - continuous monitoring of the developments in the EU as regards increasing safety and stability of the financial system so as for the measures adopted by the EC to be also implemented in the domestic legislation without any delay. Taking into account the lessons learned with the global financial crisis, an option for immediate action and reduction of costs in case of crisis will be considered, including the possibility for establishing a so-called bridge bank.
  - adopting regulations on standardized approach for determining minimum capital requirements for covering credit risk according to the first pillar under the New Basel Capital Accord (Basel 2) by mid 2011.
  - preparation of regulations on advanced approach under the New Basel Capital Accord (Basel 2) in line with the developments in the banking sector and banking supervision, which will begin in 2013.

**Leasing Sector.** In 2010, comparative analysis has been prepared comparing the domestic regulation with the regulation and the best practices in the EU Member States on supervision of leasing companies. On that basis, a framework for prudent operations and monitoring of leasing companies will be prepared in the following period.

**Sector for fully funded pension insurance.** The foundations of the reformed three pillar pension system in Republic of Macedonia, as part of the social security, has been established in 2000. The first pillar is managed by the Pension and Disability Fund and is based on the principle of pay-as-you-go financing. The Second pillar is mandatory fully funded pension insurance. The third pillar is voluntary fully funded pension insurance and it represents a base for establishment of occupational pension schemes in line with the *Directive of the European Parliament and Council Directive on the activities and supervision of institutions for occupational retirement provision 2003/41/EC and recommendations of EC.*

Currently, the fully funded pension insurance market consists of two Pension Companies for managing mandatory and voluntary pension funds and each of them manages one mandatory and one voluntary pension fund. During the period October - November 2009 the role of custodian of the pension funds was transferred from the Central Bank to the commercial banks in Republic of Macedonia, implying full operationalization of the initial system solution.



In April 2010, the Law amending the Law on Mandatory Fully Funded Pension Insurance was adopted which, among other things, sets a foundation of MAPAS' budget independence which was also recommended by the EC 2009 Progress Report. According to the amendments, the Pension Companies have an opportunity to invest up to 50% of the assets from the mandatory and voluntary pension funds in foreign securities. This addresses the recommendation by the EC 2010 Progress Report.

The legal framework regarding the pension insurance in Republic of Macedonia is expected to be concluded during 2011 with the adoption of the Law for Pension Payouts which will regulate the withdrawal and the use of the Pension Funds' assets from the second and in the third pillar.

During 2011, MAPAS will analyze the possibility for establishment of multi-funds in the second and third pillar of the pension system in order to give investment options to the pension fund members depending on their risk and interest preferences in line with their pension savings and in accordance with their life cycle.

From regulatory point of view, once the Law for Pension Payouts and the adequate secondary regulations is adopted, the reform of the pension system in Republic of Macedonia would be considered as finalized. From that point on, the efforts will be directed toward improvement of the pension system by establishing multi-funds within the pension funds.

**Insurance Sector.** The Council of experts of the Insurance Supervision Agency (hereinafter: the Agency) was elected on the 25<sup>th</sup> of August 2009 by the Parliament of the Republic of Macedonia. After the election, the Council focused its activities on organizational and technical establishment and staffing of the Agency. The short-term priority from the Accession Partnership for introduction of an independent supervision body in the insurance industry was met on the 1<sup>st</sup> of November 2009, with the establishment of the Agency as an independent regulatory body. In order to ensure further technical assistance, the Agency held working meetings with representatives of the World Bank, USAID and other international institutions open for cooperation and further support in the area of insurance.

The Agency signed 9 memorandums of cooperation, which offer solid basis for exchange of experiences with regulatory bodies and agencies from the countries in the region and beyond. The exchange of experience will help to ensure more rapid establishment of the financial markets in the country and abroad. This will accelerate the inclusion in the contemporary developments and modern processes typical for the European insurance market.

In the area of regulation, during 2010 the Agency has adopted 2 bylaws: Rulebook on acquiring of and examining the level of expertise required for activities as insurance agents, as well as Rulebook on acquiring of and examining the level of expertise required for activities as insurance brokers.



By the end of 2010, the Agency will enact the following secondary legislation:

- Rulebook on the Chart of Accounts for insurance companies and/or reinsurance companies;
- Rulebook on the Financial Statements (Balance Sheet and Profit and Loss statement) and the Annexes;
- Rulebook on standards for calculation of technical provisions;
- Rulebook on the assets covering technical provisions;
- Rulebook on calculation of the required level of solvency margin;
- Rulebook on calculation of the capital;
- Rulebook on methods of assessments of items in the financial statements;
- Rulebook on the form and content of the auditor's report;
- Rulebook on the detailed content of the certificate of licensed actuaries and
- Rulebook on calculation of minimum liquidity.

By the end of 2010, by-laws regulating the licensing procedure for insurance agencies and insurance brokerages companies, as well as the licensing procedure for insurance agents and insurance brokers will be adopted. In addition, deriving from the reform activities in the area of licensing, additional instructions defining into more detail the procedures and rules related to the issuance of licenses in compliance with the law and the minimum standards of operation of insurance agents will also be adopted.

In its operations, the Agency endeavors to be transparent and to meet the needs of market participants and other interested parties, publishing information and data on its web site. The Agency's web site offers useful data and information regarding the operation of the insurance entities and the agency it self.

In line with the Agency's Strategic Plan, in the period 2011 - 2013 further harmonization to the European directives will continue in order to achieve further harmonization of the primary and secondary legislation with the European principles and standards in accordance with the provisions in SAA. In the following period, the Agency will also work on introduction of supervisory rules, standards, and principles in line with the IAIS Rules, as well as on introduction and implementation of procedures, methods, and manuals for conducting (off-site and on-site) supervision, plan and procedures for further implementation of a risk-based supervision, which will contribute to overcoming the comment of the EC in the 2010 Progress Report.

Also, the Agency will focus on raising the public awareness of the insurance and supervision role and on the provision of a higher level of protection of the rights and interests of the insured persons. Priorities and main objectives of the Agency are:

- development of secondary legislation in the area of insurance;
- introduction of a risk based supervisory approach;
- creation of applications for using technical assistance;
- further education and training of the Agency staff;
- signing memoranda of understanding with relevant institutions in the country and abroad, and



- implementation and development of software for supervisory purposes.

Furthermore, the Agency will organize trainings and exams for licensed actuaries, as currently this profession is considered to be deficient. A new Insurance Law, which would implement the latest EU Directive 2009/138/EC (Solvency II) is envisaged to be enacted as well. To ensure the implementation of this Directive, the Ministry of Finance will ask the EC for technical assistance.

**Capital market.** In April 2010, the Law amending the Law on Securities was enacted, which provides further harmonization with the EU legal order. The main amendments introduced by this Law are: establishment of securities investors compensation fund as an instrument for investors protection, establishment of Guarantee Fund (functional from the 1<sup>st</sup> of January, 2011) as an assurance for the capital market participants from any inability for stock exchange transactions settlement.

Additionally, rules and standards for acquiring qualified participation in a brokerage house, stock exchange and securities depository were introduced, as well as so-called omnibus (aggregate) account, which reduces the administration and costs for non-resident investors. At the same time, an obligation was imposed for brokerage houses to maintain the level of own assets according to risk.

In order for the Guarantee Fund to become operational from January 1<sup>st</sup> 2011, adoption of Rules for operation, method and amount of payments and usage of funds for settlement of obligations of the depository members, in case there is lack of funds for settlement of commercial transactions with securities is envisaged.

In the past period, MSEC adopted 42 bylaws aiming at effective implementation of the Law on investment funds and the Law amending the Law on securities. In order to attract foreign and domestic investors in securities and to increase the market liquidity, electronic trading (giving orders electronically by using electronic signature) was introduced in 2009. For the purpose of relaxation of the securities market and increase in the volume of trading, the fees charged by the MSEC and the stock exchange were reduced.

In the period 2011-2013, the activities in the area of the capital market, will be focused on further harmonization with the EU legislation, with the purpose of establishment a modern, market oriented, stable and competitive financial sector. Also, the continuous process of harmonization of the legislation through implementation of the objectives and priorities in line with the IOSCO Strategic Direction 2010-2015 will continue in the future. Accent will be given on acceptance of guidelines and recommendations for establishment of mechanisms for cooperation between national regulators for more efficient implementation of supervision.





### 4.3. Labor market

#### 4.3.1. Education

The educational process is striving for a knowledge-based society, binding the educational process with the labor market needs and upgrading professional qualifications and skills in order to increase employment opportunities.

**Science and research.** The main challenge in this area is achieving of a practical correlation between higher education experiences and scientific and technological acknowledgments through investments in technological parks and innovation centers, designed as public - private partnership. This priorities will be envisaged in the 2011 – 2015 National Programme for Research and Science which is currently being prepared. The Program is in final phase of preparation and is expected to be officially adopted during 2011. Regarding Community programs, more specific in the Framework Programme FP7, there is a continuous increase in the effectiveness, reaching participation rate of 14% in programs which is in line with the EU average of 15-16%.

Aiming at creation of new possibilities for increased participation of the Macedonian scientific community into the European scientific area, National representatives have been assigned to ESFRI (research infrastructure), SGHRM (mobility) and CREST (scientific and technical cooperation committee).

Public investments for science and research were also increased through two capital projects: a) Project for translations of 500 scientific books and textbooks, while additional 500 books are planed for the second phase of the project, and b) Project for laboratory equipment for the institutions in the areas of technical, medical and biotechnical sciences and humanities, with a main goal of strengthening the applicative infrastructure in the state - owned higher educational institutions and public institutions of science.

In line with meeting the remark in the 2010 Progress report, Republic of Macedonia is aspiring towards larger participation in European research network, as well as towards creating conditions for larger public and private funding in research and science area.

**Higher Education.** Significant advancement has been achieved in the implementation of the Bologna Declaration. Regulations regarding management of the financial resources accumulated by tuition fees and students' co-financing are consisted in Law amending the Law on Higher Education, adopted during 2010. Four Bylaws and Decree on National framework for Higher Educational qualifications have also been enacted.

In order to improve the net of public higher education institutions, 14 new dispersed higher education study programmes and one new faculty were established. It is important to underline that in school year 2009/2010, 89.2% from high school graduates





enrolled in higher educational institutions. The Project 35/45 – Higher education for adults was launched in the current school year 2010/2011, with 400 students in the first generation.

For the period 2011-2013 the following activities are envisaged:

- national ranking of universities, university units and colleges;
- establishment of new public bodies: National Board for accreditation and evaluation of the higher education and National Council for higher education development and financing, deriving from Law on Higher Education;
- implementation of the adopted Decree for Higher Education National Framework.

**Reforms in the primary and secondary education.** Aiming at the quality increase in the areas of primary and secondary education, the following regulations have been modified and/or amended: Law on Primary Education, Law on Secondary Education, Law on Bureau for Development of Education, Law on Vocational Education and Training, Law on State Examination Center and Law on State Educational Inspectorate. These changes introduced self-evaluation, integral evaluation and external evaluation.

For quality implementation of the reform involving nine years primary and compulsory secondary education, more than 130 school buildings (100 primary schools and 30 secondary schools) were constructed or reconstructed during 2009 and 2010. In addition, free transportation for all students as well as free accommodation for students with permanent address in cities other than the school institutions were provided. Also, for the ongoing project *“Computer for every child”* designed to promote IT technologies in the educational process, computers for students in 663 new locations within the educational institutions were provided.

According to the Accession partnership priorities, for effective inclusion of the children from vulnerable groups, the following activities have been undertaken: free textbooks for all, scholarships (800 scholarships for Roma students in 2009/2010 and 650 in 2010/2011), as well as mentorship programme. Striving for increasing the number of students in secondary education whose parents receive social allowances, as well as realization of compulsory secondary education, conditional cash transfers are provided for the school year of 2010/2011. Procedures for introducing 4-year secondary education, for students with special needs are undergoing as well. In addition, a curriculum for the 3<sup>rd</sup> to 4<sup>th</sup> year vertical mobility for students with special needs was prepared. Also, the preparation of concept for vocational education for students with special needs is currently ongoing.

Regarding ethnic communities integration in educational process and according to the OSCE's High Commissioner for National Minorities recommendations, the Strategy for Integrated Education was adopted in 2010. This Strategy envisages measures in 5 groups: promotion of integration through joint curricula and additional activities, integration through language learning, teaching plans, programmes and textbooks,

increase qualifications of lecturers and assistant lecturers regarding the integration, as well as decentralized school-management.

For the period 2011-2013 the following activities have been envisaged:

- development and adoption of the Law on Secondary Education;
- enhancement of the decentralization process;
- further improvement in the legislative framework for primary, secondary and post-secondary education;
- improvement of infrastructural and technical conditions in the primary and secondary education institutions;
- increased number of students from vulnerable groups enrolled in primary and secondary education;
- implementation of the activities envisaged in the Strategy for Integrated Education;
- participation in PISA and TIMSS;
- development of e-content for all teaching courses;
- training for teachers and management team of the educational institutions;
- development of National framework for qualifications, preparatory activities for introduction of ECVET and EQARF;
- involvement in the European school network through the e-Twinning portal of the EC;
- towards strengthening of the relation between educational profile and labor market needs, implementation of the newly adopted concepts for post-secondary education and vocational education based on the recommendations of the European initiative for development of vocational education and training are planned. The concepts are response of labor market changes and changes in the society and on the increased demands for establishment of efficient vocational education and training.

**Reforms in the Vocational Education and Training.** The Law amending to the Law on Vocational Education and Training was adopted in 2010, with a particular goal of increasing the quality of the education process and aligning vocational education to the labor market needs. Hence, systematic evaluation of the 4-years vocational education is being executed and 14 new vocational standards are prepared. In addition during 2010, Protocol for cooperation in the vocational education and training area is signed and new partnership was established with the foreign secondary education institutions.

For the period 2011-2013 the following activities are envisaged:

- preparation of Strategy for vocational education and training development;
- preparation of Integrated concept for vocational education and training;
- revision of the 4-years' teaching programmes for technical vocations;
- reforms in the post-secondary education;
- development of vocational standards and vocational qualifications' standards for all levels of the vocational education;



- development of vocational qualifications system as a part of National qualifications framework;
- establishment of quality assurance system;
- continuous labor market needs analyses in cooperation with social partners;
- upgrading cooperation with social partners.

**Reforms in adult education.** In order to finalize the legislative framework for adult education, 5 bylaws were adopted during 2010. In addition, a Strategy for adult education was prepared and in the following short-term period preparation of the Action Plan for the implementation of the Strategy is being envisaged. Under the EU IPA programme, there are on-going activities for development of adult education programs, programs for literacy and completion of primary education of socially vulnerable groups.

For the period 2011-2013 the following activities are envisaged:

- adoption of Rulebook for verification manner of the particular adult education programs ;
- adoption of Rulebook for accreditation manner of institutions providing adult education;
- establishing a system for monitoring and support of adult education;
- promotion of career development and professional advancement;
- strengthening the cooperation between the local administration and the social partners;
- development of system for vocational qualifications for adults, as a part of National Framework for Qualifications.

All of the ongoing and planned activities listed above are towards obtaining skills and qualifications in - line with labor market needs.



Matrix of budget implications (in Denar million)

Description of policy	2010	2011	2012	2013
<b>1. Program for strengthening of the dialogue and cooperation between ethnic communities</b>				
A. Implementation profile*	X		X	
B. Net direct budgetary effects (if any)	0	0	0	--
B.1 Direct effect on budgetary revenues	82,081,278	76,383,698	74,755,948	--
B.2 Direct effect on budgetary expenditures	82,081,278	76,383,698	74,755,948	--
<b>2. Support of the integration of ethnic communities in the educational process</b>				
A. Implementation profile*		X	X	
B. Net direct budgetary effects (if any)	--	7,715,052	2,304,508	--
B.1 Direct effect on budgetary revenues	--	43,718,505	13,058,756	--
B.2 Direct effect on budgetary expenditures	--	51,433,557	15,363,264	--
<b>3. Conditional cash transfers</b>				
A. Implementation profile*	X			X
B. Net direct budgetary effects (if any)	0	0	0	0
B.1 Direct effect on budgetary revenues	230,801,625	230,801,625	230,801,625	230,801,625
B.2 Direct effect on budgetary expenditures	230,801,625	230,801,625	230,801,625	230,801,625
<b>4. Increasing the scope of socially vulnerable groups in primary and secondary education</b>				
A. Implementation profile*	X	X		
B. Net direct budgetary effects (if any)	580,704	580,704	--	--
B.1 Direct effect on budgetary revenues	0	0	--	--
B.2 Direct effect on budgetary expenditures	580,704	580,704	--	--
<b>5. Evaluation Agency</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	800,000	800,000	800,000
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	800,000	800,000	800,000
<b>6. Council for Development and Financing of Higher Education</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	1,300,000	1,300,000	1,300,000
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	1,300,000	1,300,000	1,300,000
<b>7. Higher education for adults</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	73,856,400	98,475,200	123,094,000
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	73,856,400	98,475,200	123,094,000
<b>8. Project for Ranking higher education institutions</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	21,000,000	21,000,000	21,000,000
B.1 Direct effect on budgetary revenues	--	0	0	0
B.2 Direct effect on budgetary expenditures	--	21,000,000	21,000,000	21,000,000
<b>9. Program for strengthening human and institutional capacities</b>				
A. Implementation profile*	X	X		
B. Net direct budgetary effects (if any)	0	--	--	--
B.1 Direct effect on budgetary revenues	6,619,520	--	--	--
B.2 Direct effect on budgetary expenditures	6,619,520	--	--	--
<b>10. Modernization of the education system and training system</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	10,644,756	5,286,650	3,238,670



B.1 Direct effect on budgetary revenues	--	60,320,343	29,957,743	18,352,484
B.2 Direct effect on budgetary expenditures	--	70,965,099	35,244,393	21,591,154
<b>11. Increasing the employability skills</b>				
A. Implementation profile*	X	X		
B. Net direct budgetary effects (if any)	0	0	--	--
B.1 Direct effect on budgetary revenues	723,233	1,084,850	--	--
B.2 Direct effect on budgetary expenditures	723,233	1,084,850	--	--
<b>12. Support for adult education and development programs for adult education, literacy programs and completion of primary education</b>				
A. Implementation profile*		X		X
B. Net direct budgetary effects (if any)	--	8,479,036	4,704,476	2,771,651
B.1 Direct effect on budgetary revenues	--	48,049,144	26,658,819	15,705,958
B.2 Direct effect on budgetary expenditures	--	56,528,180	31,363,294	18,477,609
<b>13. Establishing vocational secondary education for persons with completed only primary education</b>				
A. Implementation profile*	X			X
B. Net direct budgetary effects (if any)	1,300,000	2,000,000	5,000,000	7,000,000
B.1 Direct effect on budgetary revenues	0	0	0	0
B.2 Direct effect on budgetary expenditures	1,300,000	2,000,000	5,000,000	7,000,000
<b>Total net budgetary effect</b>				
Total effects on budget revenues	320,225,656	460,358,165	375,232,890	264,860,067
Total effects on budgetary expenditure	322,106,360	586,734,113	514,103,724	424,064,387

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

#### 4.3.2. Labor market reform

Improving the conditions on the labor market is one of the main priorities arising from the Accession Partnership of the Republic of Macedonia with the EU. Hence, the Republic of Macedonia implemented reforms on the labor market in 2009 and 2010, mainly aimed at:

- harmonizing supply and demand of labor force and job creation, in line with the labor market needs;
- increasing employment;
- further improvement of the legislation and its harmonization with the Acquis Communautaire;
- encouraging and developing functional and representative social dialogue at all levels, as well as encouraging collective bargaining; and
- further improvement of labor market capacities.

For the purpose of achieving the above-mentioned goals, as well as reducing grey economy, being in line with the priorities of the Accession Partnership of the Republic of Macedonia with the EU, in 2009 and 2010, the Government implemented annual active employment programmes and measures, continuously harmonizing the labor legislation and strengthening the capacities of the labor market institutions, in cooperation with the social partners, having effects on realizing the goals and the activities contained in the 2010 National Employment Strategy and the 2009–2010 National Employment Action Plan. It is important to mention that there is constant monitoring of the



implementation of active measures and there are efforts towards improvement of their efficiency and effectiveness in order to increase the real value added in the economy.

To the end of achieving the medium-term priority under the Accession Partnership, in the past period, the Government focused its efforts in particular on unemployment reduction of young population, long-term unemployed, women and other vulnerable groups.

In 2009 and 2010, the Employment Agency (hereinafter: the Agency), continuously implemented regular and other activities for strengthening the capacities for efficient implementation of employment policies, their monitoring and performance assessment, as well as activities for introducing new service model in line with the EU recommendations and criteria. Thereby, its transformation process was supported under the *CARDS Employment Policy Project-phase 3*, after which completion, the Agency continued with the introduction of the new service model in all employment centers. Its adoption was accompanied with new types of services (call center and Open office as new type of services for job seekers and employers), full integration in the records of ISCO Classification of Occupations, commenced activities for preparation of the Agency for participation in EURES, and, to the end of enhancing the activity, trainings for all employees were carried out. The model was also implemented by upgrading the IT system. In order to support all operation processes, implementation of new software application for the overall operations commenced in 2009. In addition, to the end of improving quality of existing services, software for electronic services was also implemented through the Agency web-portal, and thereby new services for self-informing and mediation during employment were also introduced.

For the purpose of meeting short-term priority under the Accession Partnership, during 2009 and 2010, intensified activities were undertaken to strengthen capacities of the State Labor Inspectorate (SLI), to the end of transposing EU directives in the field of safety and health at work, many trainings were organized related to implementation of adopted regulations harmonized with EU directives. Software for SLI needs was prepared and put into operation, being web-application connected to many institutions (Central Registry of the Republic of Macedonia, Public Revenue Office, Employment Agency of the Republic of Macedonia, Civil Servants Agency, Pension and Disability Insurance Fund, social work centers, Administrative Court, Public Health Institute, Ministry of Health and Association of Protective Companies).

In addition, to the end of enhancing social dialogue, being short-term priority under the Accession Partnership, Government of the Republic of Macedonia and the representative social partners signed new Agreement for Establishing Economic and Social Council (ESC) on 25<sup>th</sup> August 2010. ESC is national three-party body established by the Government of the Republic of Macedonia and the social partners for conducting social dialogue, aimed at creating conditions for economic and social stability and attaining the fundamental values of the Republic of Macedonia, as democratic and social country.





In the period 2011–2013, activities will be focused on further labor market reforms, to contribute to job creation, being in line with the Accession Partnership priorities, as well as the EC recommendations in the 2010 Progress Report. Planned activities will be realized with continuous increase of the funds and the number of persons covered under the active employment programmes and measures, in line with the labor market needs. Policies will be aimed at encouraging and supporting employment of unemployed persons, facing difficulties to enter the labor market (young people, long-term unemployed, women, disabled persons, etc.), for the purpose of increasing their employment and competitiveness on the labor market, as well as reducing grey economy.

2010-2020 National Strategy on Poverty Reduction and Social Exclusion in the Republic of Macedonia will be also implemented, to contribute to improving employment conditions and opportunities and unemployment reduction, improving living standard and strengthening social cohesion and sustainable demographic development.

One of the key priorities under the Accession Partnership, on the short and medium run, is enhancing the protection of disabled persons. Thus, in the coming period, possibility for introducing quota (percentage) system for employing disabled persons in both the public administration and the larger companies will be analyzed. Goal of introducing this system is to extend the scope of employment of disabled persons in the protective companies, and in the open economy.

In the coming period, Twinning Project –Support to the National Employment Policy will be also implemented. Project is aimed at strengthening capacities of employees in the Ministry of Labor and Social Policy, as well as other competent bodies and institutions, as regards long-term forecasts on the labor market and monitoring and evaluation of employment policies.

Main challenges on the labor market will be defined in line with the European economic Strategy – Europe 2020, for which national strategic and operational documents will be also prepared. They will envisage measures for reducing structural unemployment, development of qualified labor force meeting the labor market needs, adjusting the system of vocational education and training according to the labor market needs, coupled with efficient incentive for life-time learning, enhancing social inclusion, fight against poverty, grey economy, etc.

In addition, in the period 2011-2013, harmonization of the legislation with the Acquis Communautaire will continue, by transposing the directives related to protection of workers in case of insolvency of employers and workers' councils.

Furthermore, strengthening the capacities of social partners will continue, among other through their active participation and greater commitment to preparation and implementation of employment policies, in the process of transposing the legislation, by



improving the ESC operational level and efficiency, as well as encouraging the three-party social dialogue at local level as well. Social partnership is envisaged to also play important role in the changes that should be realized in the vocational education and training, to the end of providing qualified labor force, corresponding to the labor market needs. Through this Progress Report for Republic of Macedonia for 2010 comments referring that the tripartite and bipartite social dialogue remain weak and there is not enough commitment and strategic approach by the Government to provide adequate and effective participation of social partners in the process of developing policies will be overcome. The capacity of social partners to contribute to the development of employment policies and social policies, continues to be weak.

In the period 2011-2013, the labor market will continue to implement the following activities that address the remarks in the Progress Report for Republic of Macedonia in 2010 in the area of employment policies:

- implementing active employment programmes and measures under the Operational Plan for Active Employment Programmes and Measures and other employment programmes;
- adoption of a National Employment Strategy, by the end of 2011;
- adoption of National Action Plan for Employment 2011-2012, by mid-2011;
- an annual operating plan for active programs and employment measures for 2011;
- developing employment services by increasing the scope of beneficiaries and strengthening the individual approach when working with the unemployed persons, in particular persons facing less possibilities on the labor market (young people, long-term unemployed, disabled persons, women, etc);
- implementing grant for EARM "*Support for employment of young persons, long-term unemployed and women*". Direct grant financed under IPA Component 4.;
- implementation Program grant "Improving the potential for employment (employability) of women from minority ethnic groups in the labor market", financed under the fourth component of the IPA. These grants will provide support to projects of civil society organizations, aimed to enable women primarily from minority ethnic groups to improve their employability through training tailored to their needs and the needs of the labor market;
- monitoring labor force fluctuation and forecasts by employers regarding new employments, by carrying out analysis of the needs for skills/qualifications on the labor market in the Republic of Macedonia;
- enhancing activities for informing and promoting EARM services;
- continuous development of the IT system and
- strengthening institutional capacities of the Agency.

In the period to come, activities for increasing effectiveness and quality of inspection supervision will continue, thus also contributing to improving labor market conditions. For this purpose, during the year 2011-2012 under IPA component 4 project for strengthening the capacities of the State Labor Inspectorate and the creation of conditions for greater, systematic and coordinated participation of the inspectorates and social partners in the effort to deal with informal economy, will be implemented.



**Matrix of budget implications (in Denar million)**

Description of policy	2010	2011	2012	2013
<b>1. Twinning Project: Support to the National Employment Policy</b>				
A. Implementation profile*	X		X	
B. Net direct budgetary effects (if any)	0	4,840,419	4,840,419	--
B.1 Direct effect on budgetary revenues	0	55,104,000	55,104,000	--
B.2 Direct effect on budgetary expenditures	0	59,944,419	59,944,419	--
<b>2. Annual Operational Plans for Active Measures on the Labor Market and Self-Employment Programmes through Loans<sup>21</sup></b>				
A. Implementation profile*	X	X	X	X
B. Net direct budgetary effects (if any)	624,294,750	599,160,000	660,000,000	700,000,000
B.1 Direct effect on budgetary revenues	17,776,350	0	0	0
B.2 Direct effect on budgetary expenditures	642,071,100	599,160,000	660,000,000	700,000,000
<b>3. Support to Employment of Long-Term Unemployed Young People and Women</b>				
A. Implementation profile*	X	X		
B. Net direct budgetary effects (if any)	8,229,726	3,771,958	--	--
B.1 Direct effect on budgetary revenues	46,635,117	21,374,429	--	--
B.2 Direct effect on budgetary expenditures	54,864,843	25,146,387	--	--
<b>4. Modernization of Employment Agency of the Republic of Macedonia</b>				
A. Implementation profile*		X	X	
B. Net direct budgetary effects (if any)	--	12,512,421	1,390,269	--
B.1 Direct effect on budgetary revenues	--	70,902,259	7,878,029	--
B.2 Direct effect on budgetary expenditures	--	83,414,680	9,268,298	--
<b>5. Strengthening the capacities of the State Labor Inspectorate and the creation of conditions for greater, systematic and coordinated participation of the inspectorates and social partners in the effort to deal with informal economy,</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	8,302,500	922,500	--
B.1 Direct effect on budgetary revenues	--	47,047,500	5,227,500	--
B.2 Direct effect on budgetary expenditures	--	55,350,000	6,150,000	--
<b>6. Improving the potential for employment (employability) of women from minority ethnic groups in the labor market,</b>				
A. Implementation profile*		X		
B. Net direct budgetary effects (if any)	--	9,328,320	5,257,180	--
B.1 Direct effect on budgetary revenues	--	52,860,480	29,734,020	--
B.2 Direct effect on budgetary expenditures	--	62,188,800	34,991,200	--
<b>Total net budgetary effect</b>				
Total effects on budget revenues	64,411,467	247,288,668	97,943,549	
Total effects on budgetary expenditure	696,935,943	885,204,286	770,353,917	700,000,000

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

<sup>21</sup> Envisaged funds include only the budget expenditures. Additional financial resources are expected to be provided through different donors and projects in the coming years



## 4.4. Agriculture and agricultural policy

### 4.4.1. Agriculture and rural development

The policy of the Government of the Republic of Macedonia for development of the agriculture and rural areas is aimed at achieving the underlying strategic objectives of the National strategy for agricultural development and rural areas 2007-2013:

- increasing the competitiveness of Macedonian agriculture;
- increasing the income of agricultural holdings;
- providing consumers an access to safe, healthy food;
- optimizing the utilization of scarce land, forest and water resources in a way that will not affect the environment adversely;
- establishment of sustainable rural communities through integrated rural development and reduction of urban-rural disparities in development;
- construction of appropriate, effective public and private institutions for implementation of agricultural and rural development policy.

The overall development policy is implemented through measures of direct subsidies from the Program for financial support for agricultural development through fully co-financing program for financial support for rural development through capital funding of infrastructure development projects for villages, Water and Forestry and by expenditure on health and care of animals and plants as complementary activities for development of crop and livestock production and food security.

In line with the Accession Partnership priorities, land registry of the state agricultural land as well as recording of the contracts for monitoring the timely payment of obligations was continuously being implemented during 2010. Full functionality of the land registry, which will lead towards meeting the 2010 Progress Report remark, has been envisaged for the following mid-term period.

**Land Policy.** In the area of land policy the following activities are planned for the following mid-term period:

- preparation of long-term Strategy for national policies on agricultural land;
- preventing the process of defragmentation and additional land fragmentation and providing land consolidation and analysis of opportunity to implement introduction of measures for the consolidation of agricultural land through purchase or exchange of state land. During 2011, pilot measures will be implemented in specific agricultural areas, which will be supported by the measures envisaged with the 2011 Rural Development Program;
- completing the process of distribution of agricultural land in state ownership, solving the problem with the usurpation of the state agricultural land and introduction of sustainable system for state land management and state land awarding in accordance with the actual needs and the regional structure of the agricultural activity;



- introduction of a principle for granting state land to socially vulnerable persons from rural areas whose income is below the lower limit, unemployed young families and single mothers from rural areas (in cooperation with the Ministry of Labor and Social Policy) with an corresponding support in a form of initial operating capital, co-financing of investment and advisory support with regards to management and development of the agriculture in commercial form;
- improvement of the functioning of the agricultural land market through appropriate taxation regime which encourages consolidation and is expected to bring dynamics of the land market, while at the same time improve the records (GIS system), the procedures of long-term lease and control whether the state-owned land is being properly used.

**Rural Development.** Rural development measures are being implemented with co-financing from the IPARD funds. These measures aim at improving market efficiency and competitiveness of agro - food sector, environment protection and maintenance of the areas through sound agro-ecological farming practices and application of sound agricultural practices, development of rural economy, support of local initiatives (LEADER) for implementation of local strategies for development of rural areas and establishment and operation of the local action groups (LAGs).

During 2010, many activities related to rural development were implemented. Some of the most important are the following:

- signing of multi-financial agreement for the implementation of IPARD - Programme (March the 3<sup>rd</sup>, 2010);
- amendments and modifications of the internal procedures for the implementation of the technical measure of the body IPARD Program Management IPARD terms of accreditation process (SIP CARDS 2006 project);
- list of mountain areas (a draft list of mountain areas was prepared and included as an annex to the IPARD program under the proposal for third modification of the IPARD Program);
- code of good agricultural and hygienic practices;
- operational plan for the establishment of pilot rural network in the country.

So as to successfully implement the rural development policy, the following activities are being envisaged for the period of 2011-2013, :

- preparation of a National Strategy for training in agriculture and establishing a system for assessing and improving the work / professional skills of persons engaged in the agricultural sector - farmers, artisans, micro, SMEs and other stakeholders in rural communities through informal education, lifelong learning, training , qualification and retraining;
- preparation of Agro-environmental program support and development of agricultural activities aimed at preserving the environment and biodiversity;
- establishment of a system and training of local leaders for the preparation of local strategies for development of rural areas and their implementation;





- implementation of policies for revitalization of villages with a focus on improving infrastructure and quality of life of rural population;
- introduction of uniform standards for rural housing, promotion of the potential for rural tourism and support services in rural areas;
- establishment of national network for rural development;
- providing a sustainable system of public and private advisory services for support of the development of agriculture.

**Rural credit policy.** Institutional instruments for rural crediting is conducted through the agricultural credit and discount Fund, which is integral part of the MBDP as of 2010. During 2011 the following activities are foreseen:

- connecting the crediting with the entire pre-financing needs of the investments which are part of the IPARD programme;
- analysis of the possibility for establishment of a Guarantee fund for support of projects suitable for IPARD financing, so as to provide greater support for small producers who have difficulties in providing collateral when applying for loans for the required co-financing;
- providing a sustainable system of advisory services for support of the rural crediting process, as well as system for monitoring the results of the rural credit policy for its upgrade.

#### 4.4.2. Forestry

The Law on forests, Law on hunting and Law on reproductive material of forest trees regulate the forestry and hunting activities in the Republic of Macedonia. During 2010, 8 bylaws deriving from the Law on forests, the Program for extended reproduction of forests for year 2010, as well as from the 2009 Information of the health condition of forests in the Republic of Macedonia were adopted.

In the following midterm period, the following activities are foreseen: adoption of a Law amending the Law on hunting, Law amending the Law on forests, remaining by-laws deriving from the Law on forests, as well as Program for extended reproduction of forests for 2011, Program for advancement and development of hunting for 2011 and Information for forests health condition of the Republic of Macedonia for 2010 with proposed measures.

#### 4.4.3. Phytosanitary policy, food safety and veterinary policy

**Phytosanitary policy,** Law on plant health, which is harmonized with EU Directive N<sup>o</sup> 2000/29 EC, Law on plant protection products, Law on fertilizers and Law on seed and planting material regulate the Phytosanitary policy in the Republic of Macedonia. It is important to note that all of these laws are in accordance with the EU standards.





During 2010, based on the Law on plant health, 17 rulebooks were enacted which are harmonized with the EU legislation. These rulebooks regulate the area of the phytosanitary policy referring to plant health, and regulate the measures for inspection and prevention of spreading harmful organisms entering or transiting through Republic of Macedonia. Moreover, Decision for determination of entrance points where phytosanitary inspection will be conducted as well as Lists of harmful organisms, plants and plant products and other objects were enacted. Finally, the Modifications and Amendments to the Law on plant health led to considerable harmonization with the EU legislation in the field of plant health. It is important to note that Denar 12 million are provided for the implementation of the 2010 Plant health Programme. In addition, four by-laws are expected to be enacted by the end of 2010.

During 2009, the Phytosanitary Directorate withdraw the plant protection products that contained one or more active substances (according to the List of active substances that was approved for usage in plant protection products in the EU in accordance with ANNEX I of the Directive 91/414 EC) from circulation and usage in the Republic of Macedonia. In accordance with the NPAA, on the basis on the Law on plant protection products, five by-laws are expected to be enacted by the end of 2010.

In accordance with the EU uniform principles and the by-laws of the national legislation, the process of registration and preregistration is expected to begin. In addition, the plant protection products that are distributed on the markets in the Republic of Macedonia will be appropriately packed, declared and marked, which is in line with the regulations of the Law on plant protection products. These activities are expected to meet the EC remarks in the 2010 Progress report. Additionally, one-stop shop system - EXIM for issuance of import permissions for plant protection products was established.

During 2010, 5 by-laws were enacted on the basis on the Law on fertilizers, which is harmonized with the Regulation 2003/2003 EC. By the end of 2010, 15 additional by-laws deriving from the Law on fertilizers are expected to be enacted.

During 2011 – 2013 in the field of phytosanitary policy, the following activities are foreseen:

- implementation of an Action plan for preparation of by-laws deriving from the Law on plant health. These by-laws will enable monitoring of harmful organisms, establishment of register of producers, importers and distributors of plants, plant products and other objects, and establishment and implementation of passports for plants in Republic of Macedonia. Implementation of this Action plan will contribute towards meeting the EC remarks in the 2010 Progress report;
- the remaining by-laws deriving from the Law on plant protection products are planned to be enacted, while at the same time the process of registration and preregistration of the active substance and plant protection products and monitoring of plant protection products will continue;



- in the following midterm period, full implementation of the Law on fertilizers is envisaged as well as adoption of the remaining by-laws deriving from this law.

During 2009, in the area of seeds and seedling materials the Law on breeder's rights and the Law on seeds and seedling material for agricultural plants were adopted, which was followed by adoption of 4 bylaws arising from these laws during 2010.

In period of 2011-2013 the following activities are envisaged:

- adoption of the Law amending and modifying the Law on seeds and seedling materials for agricultural plants in 2011, which will incorporate the Common European Catalogue of agricultural plants varieties and abolish the import licenses for seeds and seedling material;
- drafting of the remaining by-laws arising from the Law on seeds and seedling material for agricultural plants and from the Law on breeder's rights which will contribute towards meeting the EC remarks from the 2010 Progress Report;
- in order to supply the market with high quality certified seed, a Certificate for final certified seed produced in the Republic of Macedonia will be issued;
- in order to achieve better control, labels for certified seed produced in the Republic of Macedonia which is subject of trade will be issued;
- in order to diversify the range of varieties of seeds in the Republic of Macedonia, the European Common Variety Catalogue of agricultural plants will be introduced;
- preparation of a National Variety List and Descriptive list of recommended varieties of seed and seedling materials in the Republic of Macedonia.

**Food Safety and Veterinary policy.** By the end of 2010, a new Food Safety Law is expected to be adopted, which foresees establishment of a Food and Veterinary Agency of the Republic of Macedonia as of 1<sup>st</sup> of January 2011. In addition, the new Law will establish new procedures for registration and approval of food business operators, introduction of food safety conditions in the entire food chain (production, processing, storage and distribution), import and export of food, consumers' protection, food quality and safety control systems, cooperation with international institutions, rapid alert system and crisis and emergency situations management. It is important to emphasize that this Law will lead towards meeting the Accession Partnership priorities in the area of Food safety and veterinary policy. In addition, the establishment of the Agency addresses the EC remark in the 2010 Progress Report.

In addition, 19 by-laws harmonized with the relevant EU legislation regulating the veterinary area were adopted during 2010, reaching 75% national compliance with the EU legislation in this area.

Furthermore, in order to improve the efficiency of the veterinary inspection services in the Republic of Macedonia at the central and local level, a Veterinary Information



System based on the relevant EU legislation was introduced. In the following midterm period, this system will be further developed.

At the end of 2009, public campaign was conducted in order to raise the awareness at the food operators, regarding the obligations and requirements prescribed with the EU "Hygiene package" legislation. The campaign was designed for all operators of food of animal origin, especially operators that have not yet implemented HACCP system in their companies or are in a process of its implementation.

In order to meet the Accession Partnership priorities, the Project titled *"Establishment of system for identification and registration of animals"* and its second phase *"System for identification and registration of animals"* were implemented. This places the system of identification and registration of bovine animals in the Republic of Macedonia as one of the most modern ones in Europe.

The new concept and requirements of EU, point out to the necessity for improvement of cooperation and coordination between institutions as well as inclusion of responsible institution in an integrated food and feed safety control system, covering the entire food and feed chain. Thus, in the following midterm period the priorities in the area of veterinary and food safety policy will focus on: institutional and administrative establishment of the Food and Veterinary Agency, adjustment of methods of control, implementation of the EU approach in the official controls so to ensure proper coordination within the control system, improvement of the efficiency, transparency and strict control of the budget funds spending. Moreover, the establishment of a single institution provides optimal utilization of existing human resources and material capacities, efficient utilization of funds and adjustment to the state administration reform related to its rationalization and simultaneous increase of its efficiency and effectiveness. This organizational form establishes a single system of food and animal feed control, according to the existing practices in the EU Member States and with the European legislation. In addition, in the following midterm period the implementation of HACCP system based on risk control will continue, contributing to efficient allocation of resources in the process of establishment and implementation of healthy food practices.

In the following midterm period, the implementation of a new Strategy for control and eradication of brucellosis in small ruminants will follow. Furthermore, the preconditions for transferring the competences from central to local levels of border crossing points regarding the issuance/approval of permits for import and transit shipments of live animals and products of animal origin have been fulfilled. The application software "TRACES-like" is being made according to the software employed at border crossings in the EU - "TRACES" and is fully compatible with EXIM.

A concept for using computer database for establishment of IT standards within the Ministry of Agriculture, Forestry and Water Management, which will register all types of agricultural holdings in the country was proposed. This approach will reduce the costs for



maintenance and licensing of agricultural information system, which must be established according to the European standards in order to use the subsidies, to ensure food safety and improve agriculture development planning.

**Matrix of budget implications (in Denar million)**

Description of policy	2010	2011	2012	2013
<b>1. Farm Accountancy Data Network (FADN)</b>				
A. Implementation profile*	X	X		
B. Net direct budgetary effects (if any)	3,781,763	25,042,153	--	--
B.1 Direct effect on budgetary revenues	0	0	--	--
B.2 Direct effect on budgetary expenditures	3,781,763	25,042,153	--	--
<b>2. Farm registry</b>				
A. Implementation profile*				
B. Net direct budgetary effects (if any)	1,952,500	--	--	--
B.1 Direct effect on budgetary revenues	0	--	--	--
B.2 Direct effect on budgetary expenditures	1,952,500	--	--	--
<b>3. Land Parcel Identification System (LPIS)/ Integrated administration and control system (IACS)</b>				
A. Implementation profile*	X		X	
B. Net direct budgetary effects (if any)	61,322,436	5,000,000	0	--
B.1 Direct effect on budgetary revenues	--	33,210,000	43,173,000	--
B.2 Direct effect on budgetary expenditures	61,322,436	38,210,000	43,173,000	--
<b>4. Developing and building the capacity of veterinary services for effective implementation of EU legislation</b>				
A. Implementation profile*				X
B. Net direct budgetary effects (if any)	44,686,459	71,028,000	12,200,000	0
B.1 Direct effect on budgetary revenues	24,440,000	42,770,000	36,660,000	18,330,000
B.2 Direct effect on budgetary expenditures	69,126,459	113,798,000	48,860,000	18,330,000
<b>Total net budgetary effect</b>				
Total effects on budget revenues	24,440,000	75,980,000	79,833,000	18,330,000
Total effects on budgetary expenditure	136,183,158	177,050,153	92,033,000	18,330,000

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

## 4.5. Administrative reform

### 4.5.1. Public administration reform

Further development of the public administration in the Republic of Macedonia, requires institutional stability, transparency, and establishment of administrative and professional capacity at all levels. In addition, reform of the public administration is one of the key priorities in the Accession Partnership of the Republic of Macedonia with the EU. Hence, one of the strategic priorities of the Government for the period 2011-2013 is realization of a wide range of administrative reforms, which are considered as an important pre-condition for successful integration of Macedonia into the EU. Namely, the Copenhagen criteria, among other things require the ability to assume the obligations of the membership (in order to implement the *acquis*). This *"ability" actually* means that Republic of Macedonia should have adequate *"administrative capacity"* to join the EU and after the accession process to function as an effective EU member.

During the period of 2009-2010, building the capacity for the Public Administration Reform and implementation of the Strategy for reform of public administration continued. Additionally, a series of public debates related to drafting of the new PAR Strategy were successfully conducted. Furthermore, the period of 2009 and 2010 was marked with development of continuous and stable system of training, as well as providing systematic and quality implementation of the training. In addition, the Twinning project titled *"Capacity building of the General Secretariat"* to strengthen government capacity for strategic planning and monitoring and Policy analysis and coordination, was successfully conducted.

In June 2010, within the Stabilization and Association Committee, a special working group for the reform of public administration that follows the progress of the reform of public administration was established. The goal is EC to be fully and in details informed of the undertaken steps in the process of reforming public administration and future steps in this regard, as one of the key priorities of the Accession Partnership for of the Republic of Macedonia in the EU.

During 2011-2013, the attention will be focused on creation a new Strategy for PAR - provided by IPA 2007. Additionally, a reform of administrative procedures and services of public administration will be carried out through full regulation of the system processes for managing documents applying a modern approach. Also, a "quality barometer" - system for continuous measurement of satisfaction of users of administrative services will be introduced, as well as regulatory guillotine expansion of services to citizens and simplification of the payment of administrative services by using all modern means of payment.

In the following midterm period, the civil service and human resources will be reformed. Namely, the total number employed in the public administration will be defined and at



the same time a significant reduction in temporary employees will be made. Furthermore, expansion of the activities of one of the existing authorities (Ministry of Information Society) is foreseen, which will integrate the functions of managing human resources for the civil service. Ministry of information society through modern information processes will enhance the capacities of the administration, will simplify the processes and procedures, and in the same time will minimize the impact of the human factor in providing services to citizens and business community. Meanwhile, Additionally, strategic level of planning will be introduced, as well as "top leadership" in the system of public administration. Among the listed activities, creating a model of management competencies is also foreseen. During 2011-2013, the Government will continue to strengthen the capacity for strategic planning and policy making which will increase the efficiency of public administration.

#### **4.5.2. Improving transparency and accountability of the administration**

One of the short-term priorities in the Accession Partnership is effective implementation of measures, aimed at ensuring transparency of public administration, particularly in decision-making process, and further promotion of the active participation of civil society.

In the past period, the cooperation with the Ombudsman has continued. The portal [www.uslugi.gov.mk](http://www.uslugi.gov.mk) was promoted and introduction of Action plan for the dispersion of the instrument – *"Civic Diary closer to citizens"* was introduced.

During 2011-2013, the accent will be on implementation of the Law on free access to information of public matter. In the coming midterm period, e-administration is planned to be introduced, which will enable creation of one-stop shop, introduction of five influential and integrated online services for citizens (registration, payment, data integration, delivery of administrative decisions, delivery of administrative documents), and continuous implementation of the mechanism – *"Citizen Charter"*. Furthermore, the Strategy for Cooperation between the Government and civil society will be implemented by providing a functioning network of communication and coordination of activities related to the development of civil society, promoting effective cooperation with civil society and its involvement in determining the policy and legislation related to EU integration processes.

During 2011-2013, strengthening the capacities for cooperation with NGOs will continue, while at the same time it is planned to proceed with the continued development of civil society. In addition, the focus will be directed towards supporting the policy of preventing corruption through the introduction of a new Strategy for prevention of corruption and Review of the system in order to prevent corruption.



#### **4.5.3. Strengthening of the institutional capacities**

To the end of improving Public Administration and Civil Service's efficiency, the Civil Servants Agency (hereinafter: the Agency), during the period January-September 2010, has continuously conducted training courses intended for civil servants. Namely, 44 generic trainings and 23 seminars within the Regional School of Public Administration (RESPA) and UNIDEM Campus of the Venice Commission of the Council of Europe, have been realized, involving 774 participants.

During the following midterm period, the Agency intends to further improve the legal framework encompassing civil servants' rights and obligations. In function of strengthening human capacities in the public administration and civil service, the 2011 Program for Generic Training of Civil Servants will be implemented, which contains 19 thematic training courses involving 1,200 participants. Moreover, the 2012 Program for Generic Training of Civil Servants and the 2012-2014 Strategy for Training Civil Servants will be adopted.

Besides the regular generic training, the institutions involved in the preparation of PEP have realized activities and carried out a number of specialized trainings in their areas of scope, as well as Projects for strengthening of their institutional capacities for implementation of relevant EU legislation. Some of these capacity-strengthening projects were financed through TAIEX, IPA and various other foreign donors. Such activities will continue on continuous basis during the period 2011 – 2013.

The expectation is that these activities will lead towards considerable strengthening of the administrative capacities in accordance with EU recommendations and EU Accession Partnership priorities. In addition, the expectation is that these activities will contribute towards smooth functioning and improvement of the civil service system through its development into a system that is professional, politically neutral and able to cope up with the challenges arising from EU integration processes, recognized as a strategic priority of the Government of the Republic of Macedonia.



Matrix of budget implications (in denar million)

Policy description	2010	2011	2012	2013
<b>1. Institutional improvement of the administrative structures and strengthening of the administrative capacities</b>				
A. Implementation*		X		X
B. Net direct budgetary effects (if there any)	--	53,000,000	55,000,000	56,000,000
B.1 Direct effect on budget revenues	--	0	0	0
B.2 Direct effect on budget expenditure	--	53,000,000	55,000,000	56,000,000
<b>2. Improvement of the transparency and responsibility of the administration</b>				
A. Implementation*		X		X
B. Net direct budgetary effects (if there any)	--	124,000,000	125,000,000	127,000,000
B.1 Direct effect on budget revenues	--	0	0	0
B.2 Direct effect on budget expenditure	--	124,000,000	125,000,000	127,000,000
<b>3. Implementation of the Strategy for cooperating between the Government and the civil sector</b>				
A. Implementation*		X		X
B. Net direct budgetary effects (if there any)	--	30,000,000	33,000,000	35,000,000
B.1 Direct effect on budget revenues	--	0	0	0
B.2 Direct effect on budget expenditure	--	30,000,000	33,000,000	35,000,000
<b>4. Strategy for Public Administration Reform</b>				
A. Implementation*		X		
B. Net direct budgetary effects (if there any)	--	20,000,000	--	--
B.1 Direct effect on budget revenues	--	0	--	--
B.2 Direct effect on budget expenditure	--	20,000,000	--	--
<b>5. Strategy for training civil servants</b>				
A. Implementation*				
B. Net direct budgetary effects (if there any)	14,500,000	10,350,000	14,500,000	14,500,000
B.1 Direct effect on budget revenues	100,000	0	0	0
B.2 Direct effect on budget expenditure	15,500,000	10,350,000	14,500,000	14,500,000
<b>Total new budgetary effect</b>				
Total impact on budget revenues	100,000			
Total impact on budget expenditure	15,500,000	237,350,000	227,500,000	232,500,000

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

## 4.6. Additional reform areas

### 4.6.1. Trade openness

The degree of trade openness is an important indicator and component of the economic growth. In the previous period, there was a continuous enlargement of the integration of the Republic of Macedonia in the international trade flows leading to a increase in the growth rate of trade openness.



The downward developments in the economy registered in the last quarter of 2008 and throughout 2009, resulted with significant decline in exports and import of goods. Thus in 2009, the index of economic openness declined on 82.1%, which is lower by 27 p.p. as compared to 2008.

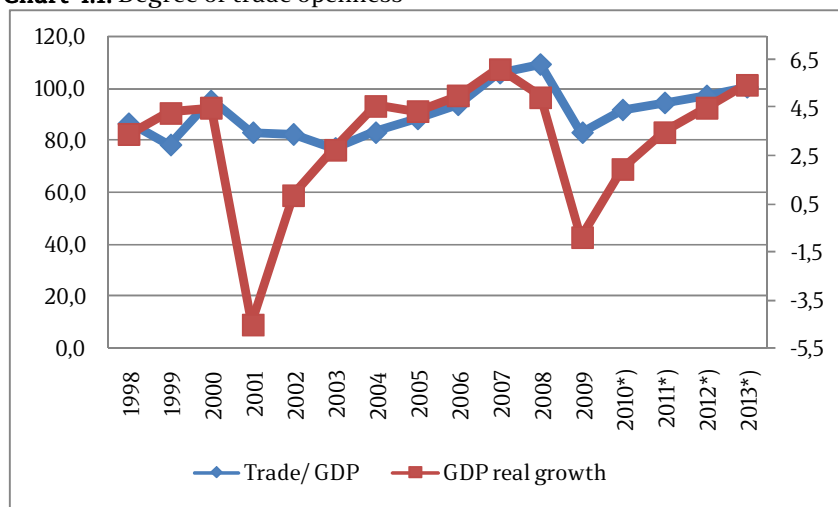
During 2010, there is certain recovery in the economic activity and improvement of the performance in the

external sector, thus trade openness in the first nine months of 2010 registered positive movement of 9.5 p.p. compared to the same period last year and it amounts 90.2% . According to the projections, trade openness is expected to reach 91.5% by the end of 2010, with a tendency of further growth in 2011 and 2012 of 94.2% and 97.1% respectively, while in 2013 the index is expected to be around 100.5%.

During 2010, the ratification of the modifications and amendments of the EFTA Agreement, lead towards expansion of the economic cooperation and trade exchange with Switzerland, Norway, Lichtenstein and Island which are member countries of EFTA. The implementation of the diagonal cummulation of origin of goods between the Republic of Macedonia, Republic of Turkey and EU were created, leading to increased export of final products with Macedonian preferential origin by using raw materials originating from EU member states and Republic of Turkey.

Signing of the Regional convention for Pan-Euro-Mediterranean preferential rules for origin of goods is expected at the beginning of 2011. At the same time, taking into consideration the advantages of the higher trade liberalization in the region, which resulted from the CEFTA Agreement, activities for establishment of a working group for assessment of possibility for additional liberalization of the services among the CEFTA member countries have started. Within the framework of the CEFTA Agreement, an analysis of the current level of openness of the markets for foreign service access of providers is conducted, which determines the service sectors with liberalization potentials, identifies of the barriers in trade with services referencing the national regulation and indifies appropriate measures for reduction and elimination of the barriers.

**Chart 4.1.** Degree of trade openness



Source: Ministry of finance and State statistical office

\*Forecast

The liberalization of the foreign trade will continue during the following midterm period, mainly through the implementation of the existing free trade agreements and through the implementation of the amendments in the free trade agreements with CEFTA 2006, EFTA, Ukraine and Turkey. During 2011, a ratification of the amendments contained in the Additional Protocol to CEFTA 2006 is being expected. The ratification of the amendments is expected to provide complete liberalization of trade in agricultural and food processing products (with the exception of wine) with the Republic of Albania and Republic of Moldova. In addition, a ratification of the modifications and amendments of the Free Trade Agreement with the Republic of Ukraine is being expected during 2011, which will provide higher liberalization in the trade of agricultural and food processing products.

#### **4.6.2. Foreign Direct Investment**

The following strategic sectors for investing are identified in the Republic of Macedonia: energy sector, manufacturing of automobile components, ICT sector, agriculture and food processing, pharmacy, textile, engineering and tourism. In line with the Law on TIDZ, special investing benefits are provided in TIDZ for foreign investors, thus stimulating the development of high and modern technologies and creation of jobs. It is important to note that this Law is in line with the EU directives in the area.

The Constitution of the Republic of Macedonia guarantees a national treatment for all investors. Since 1994, when the Republic of Macedonia became a member of MIGA, protection for FDI from political risk was provided. In addition, Republic of Macedonia has signed, bilateral agreements with 31 different countries for initiating and mutual protection of foreign investments, as well as treaties with 34 countries for avoiding double taxation.

In the area of FDI, the Ministry of Economy is responsible for creation of the investment politics, while the Agency for Foreign Investments and Export Promotion of the Republic of Macedonia (hereinafter as: the Agency) is focused on development, maintenance and implementation of the best practices and strategies for attracting FDIs and export promotion, providing services to the investors interested for investing in the Republic of Macedonia and to the Macedonian exporters as well, by providing aftercare services to companies, which are already present and have invested in the country.

On July 1<sup>st</sup> 2010, the new Law for establishment of the Agency was enforced, by virtue of which the export promotion was added as Agency's activity. This resulted with change in the Agency's name. For that purpose, the Strategy for the export promotion of Republic of Macedonia financed by World Bank's BERIS program is in the process of development. The strategy will be used as a basis for defining of program and plan for future activities related to export promotion.



In the period of 2011 – 2013, the Agency will focus on intensifying the marketing campaigns, primarily focused towards improvement of the image of the country as an attractive investment location, offering great conditions for doing business. Consequently, the Agency will increase the number of economic promoters in the countries, which generate the highest outflow of FDI on global level, aiming at positioning the country on the short list of countries in the Strategies for expansion and relocation of the business activities of the MNEs. Furthermore, the latest amendments and modifications of the Law for Establishing of the Agency and the Law on TIDZ, it is foreseen for the Agency to be the first and central point for the foreign companies, which intent to invest in one of the TIDZ.

In the period of 2011 – 2013, a close collaboration with foreign companies who already invested in the Republic of Macedonia will continue, with a goal of identifying the main challenges and problems they are facing in their business activities. The Agency will inform the ministries and other public institutions about these challenges and ask for the barriers in doing business to be eliminated. In addition, in collaboration with the business sector, the Agency will suggest amendments and modifications to the existing laws and regulations, recommending new measures in order to eliminate the identified barriers. The expectations are that these efforts will result in increasing the inflow of FDI, thus increasing the economic growth of Republic of Macedonia.

In cooperation with the business community, the investors, and the Governmental institutions, a Draft 2011–2014 Programme for Initiating Investments is being prepared. The preparation of the Programme is supported by UNCTAD and OECD. UNCTAD representatives have visited the Republic of Macedonia getting information for preparation the Report for Investment Politics.

**Matrix of budget implications (in Denar million)**

Description of policy	2010	2011	2012	2013
<b>1. Preparation of the strategy for export promotion</b>				
A. Implementation*	X	X		
B. Direct net effect on the budget (if exists)	0	--	--	--
B.1 Direct budget effect (income)	2,095,108	--	--	--
B.2 Direct budget effect (outcome)	2,095,108	--	--	--
<b>Total net budget effect</b>				
Total budget effect (income)	2,095,108	--	--	--
Total budget effect (outcome)	2,095,108	--	--	--

\* The beginning and if necessary, end of the implementation marked with the symbol "X"

#### 4.6.3. Market entry/exit

Implementation of business climate reforms is a priority of the Government of the Republic of Macedonia. Thus, improvement of the legal framework harmonized with the Acquis Communautaire, for the one-stop shop system and the companies will improve the conditions of the companies regarding running competitive business.

Implemented activities for facilitating entry and participation of entrepreneurs on the Macedonian market, contributed for the Republic of Macedonia to become a European leader in starting a business. Low costs and simple and short administrative procedures for starting a business (Table 4.2), contributed for Macedonia to be ranked first in Europe and fifth in the world, for the “Starting a business” indicator according to the latest 2011 World Bank Doing Business Report, which is improvement by 2 places compared to last year’s report. This was a result of the improvement of the legislation, including the Company Law, continuous investments in institutional and IT infrastructure, as well as introduction of interoperability between public institutions, in particular the Central Registry, the Employment Service Agency and the Health Insurance Fund.

**Table 4.2.** Market entry

Sub-indicators	Republic of Macedonia	East Europe and Central Asia	OECD
Number of procedures	3	6.3	5.6
Time	3	16.3	13.8
Costs (% income per capita)	2.5	8.5	5.3
Minimum founding capital	0	12.3	15.3

Source: Doing Business 2011, World Bank

The 2<sup>nd</sup> phase of the reforms of the one-stop shop system of the Central Registry is in its final stage and it envisages establishment of software solutions for electronic submission and confirmation of documents necessary for company registration, as well as enhancing interoperability between Customs Administration, Public Revenue Office, Pension and Disability Insurance Fund, Health Insurance Fund, Employment Service Agency, notaries and the judiciary. Thus, the realization of the Project titled “*Meta Database for legal entities*” is planned to start in 2011. The Meta Database will be used by the public institutions so as to avoid redundancy of data, as well as doubling the collection of data, and to reduce to a great extent the administrative burden on companies. The realization of this Project will be also enhanced by the adoption of the Strategy on Standards on Data Exchange in the Republic of Macedonia at the end of 2010: XBRL standard on financial data exchange and crXML standard on exchange of legally relevant data, after which the Central Registry will start its realization. Amendments to the Law on One-Stop Shop System and the Law on Trade Registry and Registry of Other Legal Entities are envisaged at the beginning of 2011, to the end of carrying out legal convalidation of all electronic software solutions.





Market exit in the Republic of Macedonia is being carried out through two procedures: liquidation procedure referring to voluntary market exit, being carried out in 14 days at the most and bankruptcy proceedings, being a court procedure, in which bankruptcy judge, creditors, debtor and trustee participate.

As of 2010 inclusive, activities for strengthening capacities of all institutions responsible for implementing the legal framework on bankruptcy are being continuously carried out, with international donors support. In general, there has been an improvement, the number of unsolved bankruptcy-related cases was reduced and the bankruptcy proceedings had been resolved in a shorter period of time. To that end, the following activities are being realized:

- preparation of analyses and monitoring bankruptcy proceedings according to several indicators: ongoing bankruptcy proceedings, duration of bankruptcy proceedings, percentage of settling creditors, review and assigning bankruptcy proceedings to trustees and to courts;
- applying, training, taking exam and licensing trustees. As of September 30<sup>th</sup> 2010 inclusive, 74 trustees for physical persons and 11 trustees for companies can conduct bankruptcy proceedings;<sup>22</sup>
- institutional and administrative strengthening of the Chamber of Trustees and promotional activities aimed at promoting the trustee profession;
- regular meetings with private sector representatives.

Improving the conditions for exiting the market will also continue in the period 2011-2013, whereby measures will be undertaken as regards to strengthening institutional capacities, transfer of knowledge to participants in bankruptcy and liquidation procedures, preparation of regular analytical quarterly reports informing the Government of the Republic of Macedonia on the main indicators measuring the closure of business, eliminating the reasons for not-resolved bankruptcy proceedings conducted under the old laws, consistent application of the principle of specialization of judges, monitoring of trustees and amending the Bankruptcy Law to the end of enabling application of electronic solutions for trustees to monitor bankruptcy proceedings.

#### **4.6.4. Rule of law and enforcement of contracts**

In the period of 2011-2013, the activities of the judiciary are focused on continuing activities for strengthening the independence and effectiveness of the judiciary, as well as continuous implementation of the reform of criminal law.

In a direction of fulfilling the Accession Partnership priorities referring to the provision of initial and continuous training at the Academy of Judges and Prosecutors, the 3<sup>rd</sup>

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<sup>22</sup> Pursuant to the new 2006 Bankruptcy Law, 260 candidates for taking exam for trustee have been trained so far, out of which 127 candidates passed the exam for authorized trustees, and 104 candidates obtained licenses.



generation will complete the initial training in December 2010 by passing final exam, while initial training for the 4<sup>th</sup> generation is currently ongoing. In July 2010, Law on the Academy for Judges and Public Prosecutors was adopted, which contains provisions aimed at creating high profile of professional staff for execution of the office of a judicial or a public prosecutor.

In addition, one of the key priorities of the Accession Partnership is to strengthen the independence of the judiciary, and the overall capacity of the judiciary. For this purpose, and for ensuring consistency of legal decisions in the judiciary, in November 2010 various laws were adopted. Their implementation is expected to significantly strengthen the independence and increase the efficiency of the judiciary. The following laws were adopted: Law amending the Law on Courts, Law amending the Law on the Judicial Council of the Republic of Macedonia, Law amending the Law on Judicial Budget, Law amending the Law on Court Service and Law amending the Law on Administrative Disputes. The most significant novelties in these laws are the following: 1) introducing of system of career progress of the judges, 2) improving of the system of disciplinary responsibility and determination of unprofessional and unethical work of judges through introducing objective and measurable criteria, 3) increasing of transparency in the work of the courts and improving the system of evaluation of judges and 4) improving the financing of the judiciary through establishing of a fixed percentage of 0.8% for the Judiciary budget in relation to GDP (this percentage will double from the current 0.4% to 0.8%, thus achieving a uniform increase in the period from 2012 to 2015). The increase in the Judiciary budget is in accordance with the recommendations of the Accession Partnership priorities to allocate adequate resources, while it is also expected to meet the remark in the 2010 EC Progress Report regarding the budget limitations.

In order to increase the efficiency of the judiciary in August 2010, the Law amending the Law on Civil Procedure and the Law on Expertise were adopted. The main purpose of the amendments to the Law on Civil Procedure is enforcement of the legal security, more efficient performance of the courts by reducing the duration of proceedings and creating a favorable business climate. The most important novelties are the obligation for the preparatory hearing, determination of deadlines for taking procedural actions, increase in the quality of submitted documents, introduction of alternative dispute resolution such as mediation, improvement of the system for delivery of the documents and introduction of electronic delivery, implementation of tone recording of hearings and prescribing penalties for violation of procedural rights in the procedure. On the other hand, the new Law on Expertise for the first time regulates this matter in a unique way, postulating clear criteria for conducting an expertise by highly professional and vocational subjects through meeting the prescribed requirements and passing of the exam, and by issuing licenses for operation, thus guaranteeing the quality of expert performance.

In accordance with Accession Partnership priorities and the remarks in the 2010 EC Progress Report, an important novelty that will further contribute towards increasing



the efficiency of the judiciary is the transfer of judicial competences for dealing with the payment orders within the competences of notaries. This means that starting from July 2011, a significant number of cases will be transferred in the competences of notaries. In addition, through the transfer of old enforcement cases that are still in the courts, to the enforcement agents, the burden of the courts will be further decreased. The Law amending the Law on Enforcement envisages that enforcement procedures that have already been started should be performed until the date of application of this Law pursuant to Law on Enforcement Procedure, but not later than July 1<sup>st</sup>, 2011.

Additionally, a significant innovation in the judiciary is the introduction of the mechanism of free legal assistance. In December 2009, the Law on Free Legal Assistance was adopted with a main goal of providing equal access of citizens to the institutions of the system. The Law was enforced on July 7<sup>th</sup> 2010 and all prerequisites for its consistent application were created. One of the planned activities in the area of justice for the year of 2011, is the adoption of the Law amending the Law on Bar.

In the area of ICT, it is important to emphasize that starting from January 1<sup>st</sup> 2010, e-judiciary functions and an application of ACCMIS is fully used in all courts in the Republic of Macedonia. By July 2010, training for all of the IT experts in the courts for applications and working with new servers (virtualization) was conducted. In order to increase the transparency of the judicial institutions on the web-sites of the courts, anonymous judicial decisions are continuously posted, thus the citizens have access to them at any time (as of December 2010 inclusive, 48,000 verdicts were posted on the web-sites). The courts have on their disposal a database of laws - LDBIS, which is continuously updated with new regulations (as of December 2010 inclusive, 21,000 laws, international agreements and other regulations were listed on LDBIS). In the area of information technology, it is important to emphasize that by September 2011, the installation of equipment for tone recording in the courts will be completed, as well as the training of personnel for its use.

Regarding the reform of criminal law, within the first segment of the reform of criminal law, in September 2009 the Law amending the Criminal Code was adopted, which began to be applied as of March 2010. The amendments refer to illicit enrichment, extended confiscation, criminal liability of legal entities, economic crime and computer crime. In the period 2011-2013, activities for harmonization the Criminal Code with the GRECO recommendations, as well as for straining of penalty policy, particularly in the area of rendering of penalties for criminal offenses will be undertaken.

The second segment of the reform of criminal law encompasses reform of the criminal procedural law under which in November 2010, a new Law on Criminal Procedure was adopted. The new Law on Criminal Procedure has a delayed application (vacation legis) of two years, i.e. 2012. For enforcement and implementation of the new Law on Criminal procedure, an Action plan was drafted by the working group built in three specific components: normative part, conducting of trainings and capacity building. The Law



envisages changes in the structure of pre-trial and judicial procedure and in the competences and the organization of main participants in the procedure. A new and proactive role of the public prosecutors in the preliminary procedure is envisaged. Basic determinants of the reform are: expansion of application of the principle of opportunity for criminal prosecution, affirmation of out of court settlement and simplified procedures, leaving the judicial paternalism by transferring the burden of proof to the parties, providing active managerial role of public prosecution office in the preliminary procedure with an effective control over the police, the abolition of judicial investigation and taking off the running of preliminary procedure by the public prosecution office. In addition, a preclusion system for certain procedural actions and measures against abuse of the procedural competences of the parties will be introduced, strict deadlines for decision-making and writing of verdicts, rationalization of the system of legal remedies, implementation of the EU and the Council of Europe documents for criminal procedure, creating of efficient public prosecution and establishing of a new operational and management structure as well as cooperation with the police and other law enforcement bodies. In this area, in the period 2011-2013, the activities will be concentrated on harmonization of all relevant laws with the new Law on Criminal Procedure, which will further facilitate its proper implementation. In this direction, in the following midterm period, the Public Prosecution Office' human, material and technical resources will be further strengthened. Referring to the application of the new Law on Criminal Procedure, numerous training courses for public prosecutors, lawyers, judges, members of the Ministry of Interior and other target groups will be organized.

Within the reform of Criminal Law, in 2010 the Law on International Cooperation in Criminal Matters was adopted. The main purpose of the Law is solidarity and transnational cooperation between states in prevention of criminal activities. Taking into consideration that this Law will have a period of vacation legis, in the forthcoming years activities will be undertaken to ensure proper conditions for its implementation. In this direction, special trainings for the entities that will implement the law will be organized.

#### **4.6.5. Obstacles for trade with goods and services and cross-border investments**

Based on the World Trade Organization's List of specific obligations in services of the Republic of Macedonia, significant liberalization was achieved on the services market by taking obligations in 115 services sectors and in great portion of them without additional restrictions.

Trade with services is usually subject to a bigger regulatory control that contributed to directing the activities towards simplification of administrative procedures and identification of barriers for trade with services. With regards to this, there are ongoing legislative activities for implementation of the Action Plan for harmonization of the European Services Directive 2006/123/EC. Additionally, preparation of a Law on Services and Establishment of "*Single Contact Point*" is being envisaged. This will enable for the

Republic of Macedonia to provide free movement of services on the EU internal market when it will become an EU member state.

Taking into consideration the advantages of establishing greater freedom of trade in the region within the CEFTA Agreement, activities for assessment of the potential for additional liberalization of services among CEFTA member states is currently being undertaken.

#### **4.6.6. Customs System**

Customs Administration (hereinafter: CA) is authority in charge of establishing and maintaining Common Communication Network and Common System Interface (CCN/CSI1) with the EC and the EU Member States. Thus, one of the requirements for accessing the Convention on Common Transit Procedure between EC and EFTA was fulfilled, pertaining to connection of the electronic system of the Republic of Macedonia for processing customs declarations with the respective systems of the EU Member States, as well as with the EU New Computerized Transit System (NCTS2).

In 2009, the Decree on Application of EC Regulations on Classification of Certain Goods in the Combined Nomenclature was amended, thus providing continuous adoption and application of EU regulations, as one of the conditions under the European integration process.

For the purpose of meeting the Accession Partnership priorities in the part of the Customs Union, in 2009, modifications and amendments were made to the Customs Law so as to harmonize it with the EU one, as well as the Council Regulation no. 2913 /1992, and modifications and amendments were adopted under Regulations 82 /97, 955/1999, 2700/2000, 648/2005 and 1791/2006, by which legal framework was introduced as regards implementation of the new electronic Customs Declaration Processing System (CDPS) in the Customs Administration. To the end of meeting the priorities, modifications and amendments to the Law on Customs Tariff were also made, thus creating legal framework for establishing Integrated Customs Tariff - TARIM, in which all tariff and non-tariff measures are integrated, in line with the existing legal regulations in the Republic of Macedonia. It is important to mention that as of January 1<sup>st</sup> 2010, administering and collection of all types of excises is transferred from Public Revenue Office to CA.

In the period 2011–2013, important strategic priority for CA is full harmonization of customs regulations with the European regulation, being in line with the partnership priorities. Improving the legislation and upgrading the excise management system are also CA strategic priority. Protection of citizens and fight against organized crime, modernization of customs service and strengthening cooperation with other government



bodies, as well as with foreign customs administrations and international organizations are of special importance for CA.

Increase in the number of companies, using simplified procedures and conclusion of agreements for mutual cooperation with economic operators, introduction of integrated customs and statistical nomenclature of EU TARIC (TARIM), as well as enhancement of supervision mechanisms are also aimed at realizing the strategic priorities. In addition, CA, has as its priority goals cooperation with economic operators and other state institutions and inspection services, improvement of cooperation and exchange of data with government bodies, other customs administrations and EU bodies, fight against illegal trade and organized crime, improvement of administrative capacity of the customs service in detecting different forms of illegal trade.

During 2011 – 2013, CA will also continue to improve ICT system for risk analysis and selectivity, to contribute to enhancing CA efficiency when detecting illegal trade and crime. CA role will be also strengthened as regards safety and protection of health, environment and intellectual property rights. Operationalization of ICT systems will contribute to overcoming the remark in the Progress Report for Republic of Macedonia for 2010.

In addition, other more significant priority goals of CA for the period of 2011-2013 are the following: modernizing customs procedure for introducing paperless environment in customs operations by implementing systems under the e-customs of the EC, establishing efficient measures against illegal trade and protecting safety and health of citizens by applying new information technologies and systems, improving business and operational processes by introducing modern systems for document management and application of new technologies in the operations, continuous availability and functionality of all operational information systems, further reorganization and strengthening of CA, improving e-learning system, strengthening cooperation with the EU and broader.

#### **4.6.7. Fiscal decentralization**

Fiscal decentralization is one of the priorities arising from the Accession Partnership of the Republic of Macedonia with the EU. As a result, the Government has committed itself to careful and phased approach in implementing fiscal decentralization. Efforts are aimed at creating necessary capacity for the municipalities to successfully perform the transferred competences and to manage financial resources necessary for their performance.

Second phase of fiscal decentralization is carried out in most of the municipalities, i.e. the phased approach in managing operating and financial resources is completed. Evaluations carried out so far show that 77 municipalities entered the second phase of





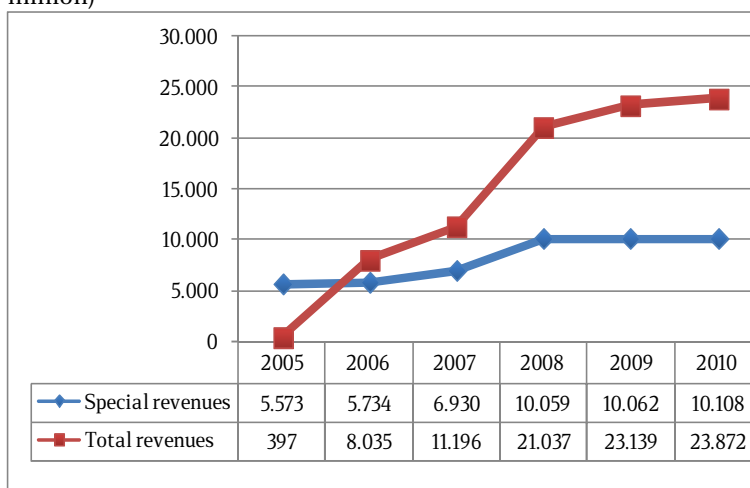
fiscal decentralization; they fulfilled the criteria for financing with block grants of the transferred competences in the field of education, child care, elderly homes and culture. For the remaining 8 municipalities, Government of the Republic of Macedonia will continue with the plan for support and implementation of reforms for enhancing administrative and fiscal capacity and access to block grants.

During 2009 and 2010, in line with the priorities under the Accession Partnership, Government of the Republic of Macedonia adopted many measures, increasing the special revenues of municipalities. Pursuant to the amendments to the Law on Financing Local Government Units, applied from 2010, percentage of VAT revenues was increased from 3% to 4.5%, whereby such percentage increase will be gradually implemented by 2013. In addition, the Law amendments provided for increasing the limit for borrowing by municipalities. At the same time, new instrument for assistance and financing of municipalities was introduced through the amendments, in the form of short-term loan (with maturity at the end of the current fiscal year, in which it was approved) and long-term loan (up to five years) from the Budget of the Republic of Macedonia. In 2010, loans have been granted to 11 municipalities (8 long-term and 3 short-term) in the total amount of Denar 81.2 million for overcoming the temporary shortage of cash resources.

In 2010, increase of revenues of certain municipalities, in particular the rural ones, was provided with the amendments to the Decree on Amending the 2010 Decree on Methodology for VAT Revenue Distribution by Municipalities. The Decree envisages fixed amount of Denar 3 million for all 84 municipalities and the City of Skopje, and a variable portion which will be distributed according to the following formula:

number of citizens - 65%, area - 27% and number of populated areas - 8%. Minimum amount of Denar 4 million of VAT was granted for smaller municipalities. This will contribute to smoother distribution revenues by municipalities, thus leading to overcoming the remark in the Republic of Macedonia 2010 Progress Report. In 2011, 3.7% of the total VAT revenues realized in the previous fiscal year is planned to be provided to municipalities on the basis of VAT grant.

**Chart 4.2.** Special and total revenues in the period 2005-2009 (Denar million)



Source: Ministry of Finance



In order to meet the Accession Partnership short-term priority, referring to strengthening transparency and accountability of municipal administration, new Rulebook on the Form and the Contents of Periodical Financial Reports of Municipalities was adopted in July 2010. The Rulebook contributed to improving the transparency in reporting by municipalities obliging them to submit periodical reports on budget execution, outstanding liabilities and borrowing. The implementation of this Rulebook contributes to overcoming the remark in the 2010 Progress Report for Republic of Macedonia.

In addition, separate laws ensured the following new revenues to the municipalities: portion of the revenues based on alienation and lease of construction land and portion of the revenues of municipalities on the basis of concessions for mineral raw materials and environmental fees.

The trend of better collection of special revenues, including transfer of all municipalities to the second phase of fiscal decentralization and financing of transferred competences with block grants is expected to continue during 2011 and on the medium term.

In 2011, UNDP funded Project "*Social Services for Support of Social Development and Inclusion*" will start. Namely, through UNDP donation almost Denar 9,5 million in 2011 and Denar 5 million in 2012 will be provided in the form of technical assistance. The project is part of the Government Programme for support to municipalities and enhancement of fiscal decentralization process. The goal is to simplify and make the distribution process more transparent, to change the existing system while retaining the grant distribution scheme. Key activity during 2011, envisaged with the Project is preparation of a model of inter-governmental transfers, which will focus on general grant and will provide smoother distribution of special revenues per capita in municipalities. In 2012, the Project will be focused on establishing minimum standards of municipal services, as well as introducing participative planning of practices for delivery of services by municipalities. Reform would be focused on redefining the technical aspects of the process, maintaining the current distribution scheme at the same time.

Currently, amendments and modifications to the Law on Financing Local Government Units are being prepared. The amendment will precise exact criteria for announcing financial instability, define measures and coordinate the process for overcoming financial instability of the municipality, cover the work of the Commission for Monitoring the Development of the System for Financing Municipalities and the Commission for Monitoring and Assessing the Fulfillment of Requirements for Moving to the Second Phase of fiscal decentralization process.

In 2012, activities for enhancing the reforms will continue, to the end of increasing the financial capacity and the independence of municipalities in carrying out their original and transferred competences.

In 2013, through a reform strategy, uniform system tools for determining minimum standards for local services, in line with the financial possibilities of the municipality and the need for additional funds, will be provided. Adequate and smoother distribution of government funds, i.e. transfer of resources for social services at local level, flexibility of funds for addressing the specific needs related to transferred competences is expected.

The decentralization, as long-term and constantly upgrading process, will continue in the following period at different levels, with a goal to achieve fully responsible and efficient local government. This will provide adequate solutions for more dynamic local economic development, higher employment rate, increase of the living standard and the quality of life, as well as stable and sustainable national economic development.

#### **4.6.8. Business Environment**

**Regulatory Reform.** The Regulatory Reforms were initiated by the Government of the Republic of Macedonia through the Regulatory Guillotine project for reviewing of existing regulation and streamlining of bureaucratic procedures, and introduction of Regulatory Impact Assessment (RIA).

The implementation of the Regulatory Guillotine Project started in 2006 and is continuously carried out in several stages, aimed at reducing the bureaucratic procedures for businesses and citizens. Hitherto, in the first phase, 2000 laws and by-laws were reviewed in cooperation with the business community and citizens and measures were prepared and carried out in 545 regulations. The second phase started in April 2009, where 54 measures were adopted towards simplification of the cross-border trading procedures.

*Third Phase of the Regulatory Guillotine.* In October 2010, the Government of the Republic of Macedonia has adopted a new package of 47 measures, which are currently under implementation. The measures relate to procedures in several areas: agriculture, labor and social policy, health, environment, insurance and more. Their implementation is scheduled to be completed by mid-2011, followed by additional consultation with the business community and determining the possibility of formulating a new set of measures for simplification of the administrative procedures.

*Regulatory Impact Assessment (RIA)* is a complementary tool of the Regulatory Guillotine Project, aimed at preventing the generation of additional administrative burdens and barriers in the new legislation. Regulatory Guillotine project will be implemented continuously until a capacity is built for implementation of RIA in by-laws, which actually hold the largest administrative burdens.

RIA's legal framework was established with Rules of Procedure for Amendments and Modifications to the Rules of Procedure of the Government of the Republic of Macedonia, Methodology for Regulatory Impact Assessment and Decision on Format

and Contents of the Regulatory Impact Assessment. RIA is referring to all draft Laws from 01.01.2009 (with an exemption of Laws adopted under an urgent procedure).

As a technical support to the RIA process, a Unique National Electronic Registry of Regulations (UNERR) was established, which enables stakeholders to submit electronic comments and suggestions directly to the government institutions. By the end of October 2010, 1,553 current regulations were included in the UNERR, 224 of which are draft-Laws that were available for public comments and that have undergone the RIA process.

In direction of administrative capacity building for RIA and its improvement, the General Secretariat of the Government of the Republic of Macedonia and the Ministry of Foreign Affairs of the United Kingdom signed a Memorandum of Cooperation in October 2010. The project titled *"Better Business Regulations in Macedonia"*, which will be implemented from November 2010 until March 2011, anticipates the following activities:

- analysis of the RIA process implementation and the UNERR functioning up-to-date;
- development of an Action plan for implementation of better regulatory reform;
- analysis of the RIA application in specific business regulations;
- analysis of the consultation process with the business community as an important part of the RIA process and development of Consultation Code.

**One-Stop-Shop for domestic and foreign investors.** In order to facilitate the process of starting and doing business in the Republic of Macedonia, as well as enabling potential investors to obtain all necessary information for the procedures and required documents in one place, the Government of the Republic of Macedonia is carrying out activities for establishment of One-Stop-Shop for domestic and foreign investors (Register). The establishment of such Registry will provide information support, mediation, compliance, technical assistance and financial information.

Taking into account the complexity of the project and the need for networking of multiple institutions, it is anticipated that the activities for introduction of the Registry will continue until 2012. A sum of Denar 6 million is planned for 2011 for the preparatory activities for the project implementation.

**Penalty policy.** In early March 2010, the Government of the Republic of Macedonia in cooperation with the chambers of commerce, associations of enterprises and business entities has identified the problems that the business community is facing when the supervision is carried out by the inspection authorities.

According to the recommendations of the business community, the first package of measures for penalty policy improvement was adopted in mid-July 2010. By September 2010, changes and adjustments of 22 laws were made.

During October 2010, measures for penalty policy improvement within 37 laws is anticipated to be implemented, as part of the second package.

According to the Action plan adopted by the Government, measures for penalty policy improvement will be incorporated in approximately 160 laws, by the end of the first quarter of 2011.

**Fourth set of anti-crisis measures.** The Government of the Republic of Macedonia in cooperation with the business community and in response to their demands, in March 2010 has adopted the fourth package of 25 anti-crisis measures.

The new set of measures was designed to facilitate the procedures for doing business in the country, improve access to credits of micro and SMEs, increase their liquidity, stimulate construction, increase privatization of land, promote employment in agriculture, improve tourism, promote export, and reduce unfair competition. The implementation of the fourth package of anti-crisis measures is expected to last until the end of 2011.

The Government continually monitors the global economic crisis and its effects on the national economy. In this direction, if the need for additional liquidity support arises, a new package of anti-crisis measures will be created in cooperation with the business community.

**Improving competitiveness.** Information on improving the competitiveness of the Republic of Macedonia with an Action plan for 2010 was prepared in coordination with all of the ministries. The Information includes about 330 measures, and is currently in governmental procedure. In addition, the Action plan includes measures proposed by the Chambers of Commerce, since part of the activities for improvement of the Global Competitiveness Index directly depend on the business community.

In addition, in cooperation with the National Entrepreneurship and Competitiveness Council (NECC), the Information on improving the competitiveness of the Republic of Macedonia with the proposed Action plan for 2010 will be analyzed, and a common platform of the Government and the business community will be prepared for improving the competitive position of the country.

Additionally, the Centre for Economic Analyses (CEA) in collaboration with USAID is preparing a National Competitiveness Report for 2010, which should indicate the competitive weaknesses and provide recommendations for improving the competitive position of the country.

Based on the National Report and the Information on improving the competitiveness of the Republic of Macedonia with the proposed Action plan for 2010, specific recommendations to improve competitiveness will be prepared for the next five-year





period of 2011 - 2015. About Denar 6 million are planned for 2011 for NECC reactivation and capacity building for its sustainability.

**Matrix of budget implications (in Denar million)<sup>23</sup>**

Description of policy	2010	2011	2012	2013
<b>1. One-Stop-Shop System for Foreign and Domestic Investors</b>				
A. Implementation *				
B. Direct net effect on the budget (if any)	--	6,000,000	--	--
B.1 Direct impact on budget revenue	--	0	--	--
B.2 Direct impact on budget expenditure	--	6,000,000	--	--
<b>2. Preparation of National Competitiveness Report for 2010</b>				
A. Implementation *		X		
B. Direct net effect on the budget (if any)	--	6,000,000	--	--
B.1 Direct impact on budget revenue	--	0	--	--
B.2 Direct impact on budget expenditure	--	6,000,000	--	--
<b>Total Net Budget Effect</b>				
Total impact on budget revenue	--	0	--	--
Total impact on budget expenditure	--	12,000,000	--	--

\* Start and, if necessary, end of the implementation marked with "X"

#### 4.6.9. Transport and electronic communication

**Road traffic.** In accordance with the Accession Partnership priorities, the Republic of Macedonia continues with the implementation of the Memorandum of Understanding for South-Eastern European major regional network and participation in the Southeast European Transport Observatory (SEETO) through the implementation and upgrading of the multi-annual SEETO plan for the period of 2011-2015.

Republic of Macedonia actively participates in negotiations on establishing a Transport Community between the EU and SEE countries, which started in June 2008. Signing the treaty is expected to happen in the second quarter of 2011, its ratification during the 2011/2012, while entering into force is expected after its ratification.

Upon an EC recommendation, in December 2009 the Government of Republic of Macedonia set up a coordinating body for the safety of road traffic, which monitors implementation of the national 2009 – 2014 Strategy for improving traffic safety on the roads. In addition, pursuant to the priorities of the Accession Partnership and the Law on Labor Relations, mandatory holidays on workers and mobile devices to record the road traffic, regulate the issue of introduction of digital tachographs in vehicles.

<sup>23</sup> Envisaged funds take into account only the budget expenditures. In the following years additional funds are expected to be provided by various donors and projects financed by international institutions.



**Rail traffic.** In the period 2009-2010, two new laws were adopted i.e. the Law on the Rail System and the Law on Safety in Rail System which incorporate the directives of the first, second and third set of railways.

In accordance with the priorities of the Accession Partnership, in 2009 the Agency for regulation of the railway sector was established, while in 2010 an Administration for safety in the railway system as a security body was established as well.

In the period 2011-2013, adoption of a new Law on Interoperability in the Railway system is foreseen. Pursuant to the Accession Partnership priorities, it is expected that the implementation of activities to compensate for part of the losses in passenger transport of passengers will continue, thus providing funding for railway infrastructure. In the upcoming midterm period, improvement of services in railway transport is envisaged, in addition to improvement and increasing the speed of rail transport by improving the performance of the railway infrastructure.

**Air traffic.** Pursuant to the Accession Partnership priorities, in May 2010 amendments to the Law on Aviation have been adopted, as well as most of the by-laws pertaining to this law.

It is important to note that in March 2010, the concessionaire TAV Macedonia DOOEL took over the operation of the airport "*Alexander the Great*" in Skopje and "*St. Paul the Apostle*" in Ohrid. In the agreement with the concessionaire, the construction of a cargo airport in Stip is also been envisaged.

Pursuant to the Accession Partnership priorities, in 2011, the following activities are foreseen: amendments to the Law on Aviation and draft amendments to the Law on Torts and Rights in Rem in air transport. In addition, a revision of the existing bilateral agreements on regular air traffic is planned, establishment of Civil-Military Committee for airspace management, and establishing a Committee for investigation of air accidents and serious incidents.

**Postal services.** Taking into consideration the need for further harmonization with the EU acquis in the field of postal services, as well as for overcoming certain ambiguities and problems faced in the implementation of the Law on Postal services from 2008, a new Law on Postal Services was prepared in 2010. Comprehensive secondary legislation arising from the new Law on Postal services will be adopted by the end of the first quarter of 2011.

The new Law on Postal Services will provide conditions for development of competition in the postal services market and further liberalization of the postal market by providing conditions for the universal service, entry of new providers of postal services, provisions to protect users of postal services and greater transparency in the work of the Postal Agency as an independent regulatory authority in the field of postal services.



During 2011, a preparation of Strategy for development of the postal market is being planned, which should determine the development of the postal sector in a manner that would establish clear and measurable goals and tasks of priority importance for the Republic of Macedonia.

**Gasification.** In 2010, the Government of Republic of Macedonia has launched bilateral negotiations for a possible connection of the national gas pipeline system with international pipelines and providing the necessary quantities of gas, as well as securing funding from IFIs, so to construct a national gas pipeline system. Based on the already developed feasibility study for the pipeline system, preliminary design was prepared for the entire national system with a total length of 849km. According to the feasibility study, the main and as-built project shall be developed for priority national route with length of 410 km divided into 5 sections. It is expected that the technical documentation will be prepared by the end of 2011 and that the construction works will start afterwards.

In addition, the Government of Republic of Macedonia initiated adoption of the Program for development of the gas economy of the Republic of Macedonia for the next 10 years and preparation of study for development of the distribution of natural gas.

**Electronic Communications.** The Agency for electronic communications (hereinafter the Agency) opened a public hearing regarding the regulatory challenges for next generation access networks (NGA-Next Generation Access Network). A document was placed on the website of the Agency on December 2009, with an aim to pinpoint all of the issues related to the regulation of next generation access networks, so as to publicly express their opinions through open discussion. In this regard and taking into consideration the last recommendation on regulation of NGN networks, the Agency began a revision of Rules on access and usage of specific network facilities in order to create a regulatory basis for the joint use of the ducts/channels and associated infrastructure.

For the purpose of price control of the operators with significant market power, especially in the provision of interconnection services and services for unbundled access to local loop or local sub-loop, as well as for provision of service for call termination in public mobile communication networks, the Agency has developed Bottom-up LRIC model.

The priorities of the Agency for the period of 2011 – 2013 are as follow:

- electronic registry of telecommunication infrastructure (under and over ground);
- revision of the bylaw that is regulating number portability;
- analysis of the numeration resources, their utilization and methodology for setting and collection of the charges;
- analysis of the need of imposing regulation for VoIP services.



Matrix of budget implications (in Denar million)

Description of policy	2010	2011	2012	2013
<b>1. Southeast European Transport Observatory (SEETO)</b>				
A. Implementation *	X			
B. Direct net effect on the budget (if any)	3,077,355	3,077,355	3,077,355	--
B.1 Direct impact on budget revenue	0	0	0	--
B.2 Direct impact on budget expenditure	3,077,355	3,077,355	3,077,355	--
<b>2 Establishment and operationalization of the Administration for safety in the railway system</b>				
A. Implementation *		X		
B. Direct net effect on the budget (if any)	--	5,416,145	12,801,797	17,725,565
B.1 Direct impact on budget revenue	--	0	0	0
B.2 Direct impact on budget expenditure	--	5,416,145	12,801,797	17,725,565
<b>Total Net Budget Effect</b>				
Total impact on budget revenue	0	0	0	0
Total impact on budget expenditure	3,077,355	8,493,500	15,879,152	17,725,565

\* Start and, if necessary, end of the implementation marked with "X"



## **PART V**

### **Annexes**



**Annex 1.** Institutions and other organizations, from which opinion on the 2011- 2013 PEP was required, are the following:

1. Ministry of Finance, Public Debt Management Department;
2. Ministry of Finance, Financial System Department;
3. Ministry of Finance, Budget and Funds Department;
4. Ministry of Finance, Customs System Department;
5. Ministry of Economy;
6. Ministry of Agriculture, Forestry and Water Management;
7. Ministry of Justice;
8. Ministry of Labor and Social Policy;
9. Ministry of Education;
10. National Bank of the Republic of Macedonia;
11. Commission for Protection of Competition;
12. Civil Servants Agency;
13. General Secretariat of the Government of the Republic of Macedonia;
14. Secretariat for European Affairs of the Republic of Macedonia;
15. Cabinet of the Vice Prime Minister of the Government of the Republic of Macedonia in charge of economic issues, Vladimir Peshevski MA;
16. Insurance Supervision Agency;
17. Employment Agency of the Republic of Macedonia;
18. Securities and Exchange Commission of the Republic of Macedonia;
19. Agency for Supervision of Fully Funded Pension Insurance;
20. Agency for Foreign Investments and Export Promotion;
21. Central Registry of the Republic of Macedonia;
22. Customs Administration of the Republic of Macedonia;
23. Macedonian Academy of Arts and Sciences;
24. "Ss. Cyril and Methodius" University, Faculty of Economics – Skopje;
25. "Ss. Cyril and Methodius" University, Faculty of Agricultural Sciences and Food – Skopje;
26. University American College, Faculty of Business Economics and Organisational Sciences - Skopje;
27. South –East European University, Faculty of Business and Economics - Tetovo;
28. State University of Tetovo, Faculty of Economics – Tetovo;
29. "Goce Delcev" University, Faculty of Economics – Stip;
30. "Goce Delcev" University, Faculty of Agriculture – Stip;
31. "St. Clement Ohridski" University, Faculty of Economics – Prilep;
32. FON University, Faculty of Economics - Skopje;
33. European University, Faculty of Economics – Skopje;
34. "Ss. Cyril and Methodius" University, Economic Institute – Skopje;
35. Association of Local Government Units;
36. Federation of Trade Unions of the Republic of Macedonia;
37. Trade Union of Agriculture of the Republic of Macedonia;





38. Independent Trade Union of Education, Science and Culture of the Republic of Macedonia;
39. Union of Independent and Autonomous Trade Unions of the Republic of Macedonia;
40. Confederation of Free Trade Unions;
41. Association of Chambers of Commerce of the Republic of Macedonia;
42. Chamber of Commerce of the Republic of Macedonia;
43. American Chamber of Commerce in the Republic of Macedonia;
44. Macedonian Civic Platform;
45. Institute for Economic Strategies and International Affairs "Ohrid" - Skopje;
46. Center for Research and Policy Making - Skopje;
47. Institute for Democracy, Solidarity and Civil Society - Skopje;
48. Center for Economic Analyses – Skopje;
49. Macedonian Center for International Cooperation – Skopje;
50. IMF Mission in Skopje, Republic of Macedonia;
51. World Bank Mission in Skopje, Republic of Macedonia.



## Annex 2.<sup>24</sup> Summary data to the Pre - accession economic Programme 2011 - 2013

**Table 1a:** Macroeconomic prospects

	ESA Code	2009 Level (euro)	2009	2010	2011	2012	2013
			Rate of change				
1. Real GDP at market prices	B1*g	6.656	-0.9	2.0	3.5	4.5	5.5
2. GDP at market prices	B1*g	6.677	-0.6	4.0	6.6	7.6	8.7
<b>Components of real GDP</b>							
3. Private consumption expenditure	P3	5.184	-3.9	1.5	2.2	3.2	4.0
4. Government consumption expenditure	P3	1.148	-6.4	-6.5	1.0	1.2	1.5
5. Gross fixed capital formation <sup>25</sup>	P51	1.819	0.9	-7.0	8.5	10.5	12.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P52+P53	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
7. Exports of goods and services	P6	3.055	-10.7	23.5	7.2	7.2	8.4
8. Imports of goods and services	P7	4.550	-11.1	8.6	6.0	6.5	7.8
<b>Contribution to real GDP growth</b>							
9. Final domestic demand		8.150	-4.0	-2.0	3.9	5.2	6.5
10. Change in inventories and net acquisition of valuables	P52+P53	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
11. External balance of goods/services	B11	-1.494	3.1	4.0	-0.4	-0.7	-1.0

Source: Ministry of Finance

**Table 1b:** Price developments

Percentage changes, annual averages unless otherwise indicated	ESA Code	2009	2010	2011	2012	2013
1. GDP deflator		0.3	2.0	3.0	3.0	3.0
2. Private consumption deflator		-1.8	1.0	3.6	3.8	4.0
3. HICP		n.a.	n.a.	n.a.	n.a.	n.a.
4. National CPI change		-8.4	2.4	1.4	0.0	0.0
5. Public consumption deflator		11.7	1.0	2.2	2.0	2.0
6. Investment deflator		-3.9	2.0	4.0	2.0	1.5
7. Export price deflator (goods & services)		-14.4	4.9	3.4	4.0	3.8
8. Import price deflator (goods & services)		-10.7	2.6	4.1	4.0	3.8

Source: Ministry of Finance

<sup>24</sup> Absolute values are expressed in billion, unless otherwise specified.

<sup>25</sup> Data refer to gross capital formation.



**Table 1c: Labor market developments**<sup>26</sup>

	ESA	2009	2009	2010	2011	2012	2013
	Code	level	Rate of change				
1. Population (thousands)			2,051.0	2,055.1	2,058.8	2,062.1	2,065.4
2. Population (growth rate in %)			0.20	0.20	0.18	0.16	0.16
3. Working-age population (persons) <sup>27</sup>			1,638.9	1,648.9	1,661.3	1,676.2	1,693.1
4. Participation rate			56.7	56.4	56.5	56.6	56.9
5. Employment, persons <sup>28</sup>			629.9	632.2	651.1	670.6	697.5
6. Employment, hours worked <sup>29</sup>			n.a.	n.a.	n.a.	n.a.	n.a.
7. Employment (growth rate in %)			3.4	0.4	3.0	3.0	4.0
8. Public sector employment (persons)			115.1	n.a.	n.a.	n.a.	n.a.
9. Public sector employment (growth in %)			5.7	n.a.	n.a.	n.a.	n.a.
10. Unemployment rate <sup>30</sup>			32.2	32.0	30.6	29.4	27.6
11. Labour productivity, persons <sup>31</sup>		647.5	-4.2	1.6	0.5	1.5	1.4
12. Labour productivity, hours worked <sup>32</sup>			n.a.	n.a.	n.a.	n.a.	n.a.
13. Compensation of employees	D1	143.2	-0.2	4.0	6.6	7.7	8.7

Source: State Statistical Office and Ministry of Finance

**Table 1d: Sectoral balances**

Percentages of GDP	ESA code	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-0.6	-0.8	2.5	1.8	0.9
of which:						
- Balance of goods and services		-22.6	-20.8	-21.1	-21.2	-21.6
- Balance of primary incomes and transfers		15.9	17.2	16.8	15.5	15.3
- Capital account		6.0	2.8	6.8	7.5	7.2
2. Net lending/borrowing of the private sector	B.9/ E D1 B.9	2.1	1.7	5.1	4.0	2.8
3. Net lending/borrowing of general government		-2.7	-2.5	-2.5	-2.2	-1.9
4. Statistical discrepancy		--	--	--	--	--

Source: National Bank of the Republic of Macedonia

<sup>26</sup> ILO definition (15+) is used for the labor market indicators.

<sup>27</sup> Age group of 15-64 years.

<sup>28</sup> Occupied population, domestic concept national accounts definition.

<sup>29</sup> National accounts definition.

<sup>30</sup> Harmonised definition, Eurostat; levels.

<sup>31</sup> Real GDP per person employed.

<sup>32</sup> Real GDP per hour worked.



**Table 1e:** GDP, investment and gross value added

	ESA code	2009	2010	2011	2012	2013
<b>GDP and investment</b>						
GDP level at current market prices (in domestic currency)	B1g	409.1	425.6	453.7	488.4	530.7
Investment ratio (% of GDP)		26.2	23.9	25.3	26.5	27.8
<b>Growth of Gross Value Added, percentage changes at constant prices</b>						
1. Agriculture		2.5	3.5	3.0	3.6	4.4
2. Industry (excluding construction)		-8.5	2.0	5.2	6.4	7.5
3. Construction		4.2	6.7	4.8	7.3	8.5
4. Services		1.1	2.8	2.8	3.4	4.3

Source: Ministry of Finance

**Table 1f:** External sector developments

In Euros	2009	2010	2011	2012	2013
1. Current account balance (% of GDP)	-6.7	-3.6	-4.3	-5.7	-6.3
2. Export of goods	1.92	2.39	2.52	2.64	2.77
3. Import of goods	3.47	3.90	4.12	4.35	4.61
4. Trade balance	-1.55	-1.51	-1.60	-1.71	-1.85
5. Export of services	0.62	0.67	0.69	0.73	0.76
6. Import of services	0.59	0.61	0.65	0.69	0.73
7. Service balance	0.03	0.06	0.05	0.04	0.03
8. Net interest payments from abroad	-0.07	-0.08	-0.06	-0.06	-0.04
9. Other net factor income from abroad	0.01	-0.05	-0.04	-0.11	-0.13
10. Current transfers	1.13	1.33	1.34	1.40	1.46
11. Of which from EU	n.a.	n.a.	n.a.	n.a.	n.a.
12. Current account balance	-0.45	-0.25	-0.32	-0.45	-0.53
13. Foreign direct investment	0.14	0.17	0.27	0.36	0.42
14. Foreign reserves	-0.07	n.a.	n.a.	n.a.	n.a.
15. Foreign debt	3.84	4.11	n.a.	n.a.	n.a.
16. Of which: public	1.32	1.39	n.a.	n.a.	n.a.
17. O/w: foreign currency denominated	n.a.	n.a.	n.a.	n.a.	n.a.
18. O/w: repayments due	n.a.	n.a.	n.a.	n.a.	n.a.
19. Exchange rate vis-à-vis EUR (end-year)	61.18	61.60	n.a.	n.a.	n.a.
20. Exchange rate vis-à-vis EUR (annual average)	61.27	61.51	61.51	61.51	61.51
21. Net foreign saving (lines 21-25: percentages of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.
22. Domestic private saving	n.a.	n.a.	n.a.	n.a.	n.a.
23. Domestic private investment	n.a.	n.a.	n.a.	n.a.	n.a.
24. Domestic public saving	n.a.	n.a.	n.a.	n.a.	n.a.
25. Domestic public investment	n.a.	n.a.	n.a.	n.a.	n.a.

Source: National Bank of the Republic of Macedonia



**Table 2: General government budgetary prospects<sup>33</sup>**

In Denars	ESA	2009	2009	2010	2011	2012	2013
	code	Level	% of GDP				
Net lending (B9) by sub-sectors							
1. General government	S13	-11.2	-2.7	-2.5	-2.5	-2.2	-1.9
2. Central government	S1311	-10.8	-2.6	-2.4	-2.5	-2.2	-1.9
3. State government	S1312						
4. Local government	S1313	-0.3	-0.1	0.0	0.0	0.0	0.0
5. Social security funds <sup>34</sup>	S1314	-0.1	0.0	-0.1	-0.1	0.0	0.0
General government (S13)							
6. Total revenue	TR	135.9	33.2	34.8	34.5	33.5	32.5
7. Total expenditure <sup>35</sup>	TE	147.1	36.0	37.3	37.0	35.7	34.4
8. Net borrowing/lending	EDP.B9	-11.2	-2.7	-2.5	-2.5	-2.2	-1.9
9. Interest expenditure	EDP.D41 incl. FISIM	2.4	0.6	0.7	0.7	0.7	0.7
p.m. 9a. FISIM		0.0	0.0	0.0	0.0	0.0	0.0
10. Primary balance <sup>36</sup>		-8.7	-2.1	-1.7	-1.8	-1.5	-1.2
Components of revenues							
11. Total taxes (11 = 11a+11b+11c)		75.8	18.5	17.8	17.9	17.8	17.3
11a. Taxes on production and imports	D2	60.4	14.8	14.4	14.4	14.2	13.7
11b. Current taxes on income and wealth	D5	13.5	3.3	2.9	3.0	3.1	3.1
11c. Capital taxes	D91	1.9	0.5	0.5	0.6	0.5	0.5
12. Social contributions	D61	38.8	9.5	9.4	9.2	9.1	9.1
13. Property income	D4	5.7	1.4	1.6	1.9	1.4	1.2
14. Other (14 = 15-(11+12+13))		15.6	3.8	6.0	5.4	5.1	4.9
15 = 6. Total revenue	TR	135.9	33.2	34.8	34.5	33.5	32.5
p.m.: Tax burden (D2+D5+D61+D91-D995) <sup>37</sup>		114.6	28.0	27.3	27.1	27.0	26.3
Selected components of expenditures							
16. Collective consumption	P32	54.5	13.3	13.2	12.9	12.0	11.6
17. Total social transfers	D62 + D63	61.8	15.1	15.2	14.7	14.3	13.8
17a. Social transfers in kind	P31 = D63	0.0	0.0	0.0	0.0	0.0	0.0
17b. Social transfers other than in kind	D62	61.8	15.1	15.2	14.7	14.3	13.8
18 = 9. Interest expenditure (incl. FISIM)	EDP.D41 + FISIM	2.4	0.6	0.7	0.7	0.7	0.7
19. Subsidies	D3	10.0	2.4	2.8	2.6	2.5	2.4
20. Gross fixed capital formation	P51	17.1	4.2	5.3	6.1	6.1	5.9
21. Other (21 = 22-(16+17+18+19+20))		1.3	0.3	0.0	0.0	0.0	0.0
22. Total expenditures <sup>38</sup>	TE	147.1	36.0	37.3	37.0	35.7	34.4
p.m. compensation of employees	D1	33.2	8.1	8.2	7.7	7.3	7.0

Source: Ministry of Finance

<sup>33</sup> The compilation of the data is based on GFS Methodology 1986.

<sup>34</sup> This item contains the deficit of Pension and Disability Insurance Fund, Health Fund and the Agency for Employment.

<sup>35</sup> Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.

<sup>36</sup> The primary balance is calculated as (EDP.B9, item 8) plus (EDP D41 + FISIM recorded as intermediate consumption, item 9).

<sup>37</sup> Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D995), if appropriate.

<sup>38</sup> Adjusted for the next flow of swap-related flows, so the TR-TE = EDP.B9.



**Table 3:** General government expenditure by function

Percentage of GDP	COFOG code	2009	2010	2011	2012	2013
1. General public services	1	2.2	2.2	2.7	n.a	n.a
2. Defence	2	1.7	1.6	1.4	n.a	n.a
3. Public order and safety	3	3.0	3.0	2.8	n.a	n.a
4. Economic affairs	4	6.1	6.5	6.8	n.a	n.a
5. Environmental protection	5	0.1	0.1	0.1	n.a	n.a
6. Housing and community amenities	6	1.1	1.6	1.3	n.a	n.a
7. Health	7	5.0	5.3	5.4	n.a	n.a
8. Recreation, culture and religion	8	0.9	0.9	0.9	n.a	n.a
9. Education	9	4.6	4.7	4.7	n.a	n.a
10. Social protection	10	11.3	11.4	11.0	n.a	n.a
11. Total expenditure (item 7 = 26 in Table 2)	TE	36.0	37.3	37.0	n.a	n.a

Source: Ministry of Finance

**Table 4:** General government debt developments

Percentage of GDP	ESA code	2009	2010	2011	2012	2013
1. Gross debt <sup>39</sup>		23.7	24.0	26.0	26.1	25.5
2. Change in gross debt ratio		3.1	0.3	2.0	0.1	-0.6
<b>Contributions to change in gross debt</b>						
3. Primary balance <sup>40</sup>		-2.1	-1.7	-1.8	-1.5	-1.2
4. Interest expenditure (incl. FISIM) <sup>41</sup>		0.6	0.7	0.7	0.7	0.7
5. Stock-flow adjustment		4.6	1.3	3.1	0.9	0.0
of which:						
- Differences between cash and accruals <sup>42</sup>		n.a	n.a	n.a	n.a	n.a
- Net accumulation of financial assets <sup>43</sup>		n.a	n.a	n.a	n.a	n.a
of which:						
- Privatisation proceeds		n.a	n.a	n.a	n.a	n.a
- Valuation effects and other <sup>44</sup>		n.a	n.a	n.a	n.a	n.a
p.m. implicit interest rate on debt <sup>45</sup>		2.9	3.3	3.2	3.0	2.8
<b>Other relevant variables</b>						
6. Liquid financial assets <sup>46</sup>		n.a	n.a	n.a	n.a	n.a
7. Net financial debt (7 = 1 - 6)		n.a	n.a	n.a	n.a	n.a

Source: Ministry of Finance

<sup>39</sup> As defined in Regulation 3605/93 (not an ESA concept).

<sup>40</sup> Cf. item 10 in Table 2.

<sup>41</sup> Cf. item 9 in Table 2.

<sup>42</sup> The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

<sup>43</sup> Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

<sup>44</sup> Changes due to exchange rate movement, and operation in secondary market could be distinguished when relevant.

<sup>45</sup> Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

<sup>46</sup> F1, AF2, AF3 (consolidated at market value, AF5 (if quoted in stock exchange; including mutual fund shares).





**Table 5:** Cyclical developments

Percentage of GDP	ESA code	2009	2010	2011	2012	2013
1. Real GDP growth (%)	B1g	-0.9	2.0	3.5	4.5	5.5
2. Net lending of general government	EDP.B.9	-2.7	-2.5	-2.5	-2.2	-1.9
3. Interest expenditure (incl. FISIM recorded as consumption)	EDP.D.41 + FISIM	0.6	0.7	0.7	0.7	0.7
4. Potential GDP growth (%) <sup>47</sup>		3.8	3.0	3.2	3.3	3.6
Contributions (percentage points):						
- labor		1.4	1.5	1.5	1.5	1.4
- capital		1.3	0.8	1.1	1.5	2.0
- total factor productivity		1.1	0.8	0.6	0.4	0.2
5. Output gap		-0.5	-1.6	-1.0	0.2	2.0
6. Cyclical budgetary component		-0.2	-0.5	-0.3	0.1	0.6
7. Cyclically-adjusted balance (2-6)		-2.5	-1.9	-2.2	-2.3	-2.5
8. Cyclically-adjusted primary balance (7-3)		-1.9	-1.2	-1.5	-1.6	-1.8

Source: Ministry of Finance

**Table 6.** Divergence from previous programme

	2009	2010	2011	2012	2013
<b>1. GDP growth (% points)</b>					
Previous programme	-0.6	2.0	3.5	5.0	
Latest programme	-0.9	2.0	3.5	4.5	5.5
Difference	0.3	0.0	0.0	0.5	
<b>2. General government net lending (% of GDP)</b>					
Previous programme	-2.8	-2.5	-2.5	-2.0	
Latest programme	-2.7	-2.5	-2.5	-2.2	-1.9
Difference	-0.1	0.0	0.0	0.2	
<b>3. General government gross debt (% of GDP)</b>					
Previous programme	24.7	26.5	27.1	27.9	
Latest programme	23.7	24.0	26.0	26.1	25.5
Difference	1.0	2.5	1.1	1.8	

Source: Ministry of Finance

<sup>47</sup> Until an agreement on the Production Function Method is reached, countries can use their own figures (SP).



**Table 7:** Long-term sustainability of public finances

Percentage of GDP	2000	2005	2010	2020	2030	2040	2050
Total expenditure	34.1	34.0	33.5	34.1	34.3	34.0	33.8
of which:	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Pension expenditure	8.2	8.5	8.8	8.8	9.0	9.0	8.8
- Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Other pensions (disability, survivors)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Health care	5.1	5.0	4.5	4.8	5.0	5.0	5.0
- Long-term care (this was earlier included in the health care)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education expenditure	4.5	4.9	4.6	4.9	5.1	5.2	5.2
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	1.8	0.9	0.7	0.9	1.0	1.0	1.0
Total revenues	36.6	34.2	31.0	33.1	33.6	33.6	33.5
<i>of which:</i> property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i> from pensions contributions (or social contributions, if appropriate)	6.9	6.2	6.1	6.4	6.6	6.5	6.4
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i> consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Assumptions</b>							
Labour productivity growth	3.5	0.5	1.6	2.4	2.0	2.0	2.0
Real GDP growth	4.5	4.4	2.0	5.0	4.3	3.6	3.5
Participation rate males (aged 20-64)	71.7	71.9	76.8	81.0	83.1	84.8	86.3
Participation rates females (aged 20-64)	47.7	49.1	50.3	54.0	59.0	63.2	67.3
Total participation rates (20-64)	59.7	60.7	63.7	67.5	71.1	74.0	76.8
Unemployment rate	32.5	37.6	32.1	23.0	16.3	13.8	12.0
Population aged 65+ over total population	:	9.4	9.7	10.5	11.3	12.2	13.0

Source: Ministry of Finance



**Table 8:** Basic assumptions on the external economic environment underlying the PEP framework<sup>48</sup>

VARIABLE	REALISATIONS AND ASSUMPTIONS FOR								COMMENTS
	2009	2010	2011	2012	2013				
(annual growth rates in %, if not otherwise stated)		<i>change*</i>		<i>change*</i>		<i>change*</i>		<i>change*</i>	
<b>Interest rates (in % p.a., annual averages)</b>									
- Short-term interest rate <sup>49</sup>	1.2	-0.1 pp	0.8	-0.7 pp	1.0	-1.5 pp			Three month LIBOR (IMF, October 2010)
- Long-term interest rate <sup>50</sup>	4.1	0.9 pp	3.6	0.1 pp					
<b>Exchange rates (annual average “-“: depreciation)</b>									
Denar/Euro	61.3	0%	61.5	0.3%	61.5		61.5		NBRM
Dollar / Euro	1.39	0%	1.33	-4.3%	1.39		1.39		1.39
Nominal effective exchange rate	106.6	-5.5%	105.6						NBRM (index 2006=100)
Real effective exchange rate **	99.7	7.4%	97.2						NBRM (index 2006=100)
<b>GDP (in real terms)</b>									
- World, excluding EU	0.3%		5.3%		4.5%		4.6%		5.5%
- EU 25	-4.2%	-0.2 pp	1.8%	0.9 pp	1.7%	0.2 pp	2.0%		2.2%
<b>World trade (in real terms)</b>									
Country export markets	56.2%		61.4%						The share of Macedonian export to EU (SSO)
World imports	-13.1%		12.1%		7.1%		6.9%		
<b>International prices</b>									
World import prices (goods, in €)	-19.0%		23.5%		4.9%		-2.5%		Percentage change
Oil Prices (Brent – USD per barrel)	62.0	0.2%	79.9	4.4%	88.9	10.4%	90.8		

\*: change vis-à-vis assumptions made for last PEP

\*\*: please indicate type of calculation (number of currencies, type of price index for deflation)

Source: European Commission, European Economic Forecast, Autumn 2010

<sup>48</sup> This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Commission together with the programme.

<sup>49</sup> If necessary, purely technical assumption

<sup>50</sup> If necessary, purely technical assumption



**Table 9:** Structural reform agenda and achievements

Major measures foreseen in previous year's PEP	Adopted (Y/N)	Date*	Comments
<b>Enterprise sector</b>			
<b>Industrial policy</b>			
Implementation of the Industrial Policy Strategy of the Republic of Macedonia (2009-2020)	Yes	2010	Continuously
National Strategy for Restructuring of the Steel Industry	Yes	2010	
Implementation of the Strategy for Development of the Textile Industry and Action Plan for Textile Industry Revitalization	Yes	2010	Continuously
<b>Support of development of entrepreneurship and SMEs</b>			
SME Observatory – monitoring and analysis of statistics for SMEs and preparation of a report	Yes	2010	
Organizing regional SMEs forums	Yes	2010	Continuously
Maintaining SME web portal	Yes	2010	Continuously
Co-financing the European Information and Innovation Center in Macedonia –(EIICM) - Enterprise Europe Network	Yes	2010	Continuously implemented
Info pult – project in cooperation with regional centers for business support	Yes	2010	Continuously implemented
Inter-Ministerial cooperation for realization of the SME Program and promotion of the new EC document - Small Business Act	Yes	2010	
Improving the access to finances for SMEs by implementing the 4 Government programs for direct credit support of micro and SMEs (MBDP)	Yes	2010	
Organizing information sessions for the availability of financial instruments for SMEs	Yes	2010-2011	
Strengthening the capacities of the newly-established business centers	Yes	2010	Continuously implemented
Co-financing projects of non-financial nature for SMEs support	Yes	2010-2011	
Preparation of new four-year program for support of entrepreneurship, competitiveness and innovation of SMEs in Republic of Macedonia, in accordance to the principles of the Small business act	Yes	2010	
Subsidizing projects for support and promotion of crafts	Yes	2010	Continuously implemented
Preparation of a national strategy and action plan for development of crafts in Republic of Macedonia	Yes	2010	
Organizing European week of SMEs, EU Day of Entrepreneurs, Global Week of Entrepreneurship and Day of Crafts in Republic of Macedonia	Yes	2010	
Preparation of Innovation Matrix for Republic of Macedonia	Yes	2010	
-Development of human resources -Voucher system of advising -Entrepreneurs awards -Entrepreneurship education -Publication of SMEs brochures -Lifelong learning-entrepreneurship	Yes	2010	Continuously implemented



-Promotion activities (fairs, work-shops, business partnerships)			
-European Week of Entrepreneurs			
Rising awareness for Information-Communication Technology	Yes	2010	Continuously implemented
Campaign for defining the needs of SMEs for implementation of standards and quality of products in accordance to legal obligations	Yes	2010	Continuously implemented
Training for small and medium enterprises	Yes	2010	Continuously implemented
Organizing local seminars for innovations and SMEs	Yes	2010	Continuously implemented
Preparation of a WEB page for the regional centers	Yes	2010	Underway
Co-financing projects within the activities of the primary and secondary schools for entrepreneurship promotion	Yes	2010	Continuously implemented
Realization of the Program for Stimulating Investments in Republic of Macedonia (2007-2010)	Yes	2010	
Realization of the National Agenda for SRE of Republic of Macedonia (2008-2012)	Yes	2010	Underway
Realization of the Program for Improvement of Competitiveness of Macedonian Products	Yes	2010	Underway
<b>Internal market-Free movement of goods</b>			
Preparation and adoption of comprehensive operational program for fight against piracy and forgery	Yes	2010	
Promotion of efficiency and effectiveness of court protection of intellectual property rights	Yes	2010	Underway
Support of associations for collective realization of copy and related rights	Yes	2010	Continuously implemented
Building knowledge, skills and awareness of individuals and business community for implementing the intellectual property rights and economic benefits from those rights	Yes	2010	Continuously implemented
Events for respecting the intellectual property rights	Yes	2010	Continuously implemented
Promotion of access to information for intellectual property rights through web pages	Yes	2010	
Realization of the Strategy for Intellectual Property	Yes	2010	Underway
Support of the business community for standardization, accreditation and metrology procedures	Yes	2010	Continuously implemented
Strategy for implementation of legislation for relevant horizontal organizations (standardization, accreditation, metrology and market surveillance) in the field of free movement of goods.	Yes	2010	
Authorization of legal entities (bodies) for performing conformity assessment for given scope	Yes	2010	Continuously implemented
Accreditation of legal entities (bodies) for performing conformity assessment for products that are circulated on the market	Yes	2010	Continuously implemented
Recognition of Macedonian products and Macedonian bodies on the internal market in EU	Yes	2010	Continuously implemented



within the ASSA			
<b>Agriculture</b>			
Adoption of the Law amending the Law on Fisheries and Aquaculture	No	2011	
Adoption of Law on Quality of Agricultural Products	Yes	2010	Edit CMO legal provisions for the fruit, vegetables, cereals, poultry meat and eggs, beef, pork, sheep and goat meat, as well as products with protected designation of origin and geographical indication tradionalni specialties.
Common core program of raising livestock for 10 years, which regulate: -Tending purposes; -Directions to the cultivation of certain species, breeds, hybrids of livestock, -Tending methods and means of realization; -Manner of publication and availability of results and Assets of the continuous implementation of the program.	Yes	2010	
Adoption Program for conservation of biological diversity in livestock (biodiversity) for a period of 7 years, with the following measures: -Preservation of all indigenous breeds / lines of cattle that are reared in the Republic of Macedonia, with special emphasis on indigenous breeds / lines in the indigenous environment; -conservation of breeds of cattle out of the environment in which occurred (ex situ conservation), in the middle where it occurred (in situ conservation) for each breed / line of livestock; -Establishment and functioning of gene banks in livestock; fulfillment of the established international practices; -Education and training in the area of conservation of biological diversity in livestock; -Raising public awareness about the importance of preserving biological diversity in livestock and -Linking with other programs in agriculture	Yes	2010	
Adoption of bylaws that will provide quality law enforcement, livestock breeding, and thus promote livestock production as a whole.	No	2010-2011	In progress
Adoption Program for Promotion of fisheries and aquaculture in the Republic of Macedonia for a period of 12 years.	No	2011	
Assist and strengthen the Macedonian Government in setting main directions for developing a comprehensive rural land development policy and development of land market.	No	2011	In progress Macedonian-Dutch Project for land consolidation-STIMERALD
Program for financial support in agriculture in 2010	Yes	2010	





for: -Plant production; -For livestock production; -Introducing safety standards in agricultural production and quality control; -Organic agricultural production and; -General and special measures for agricultural development			
Adoption of Programme of measures to promote the development of fisheries and aquaculture in 2010	No	2011	The program will include measures planned financial support for the protection and development of aquatic flora and fauna, financial support in aquaculture and fisheries, and special measures for the implementation of the activities of the Law on Fisheries and Aquaculture.
Adoption of the orientation plan for the execution of the autumn and spring sowing in the 2010/2011 production year.	Yes	2010	
Implement a procedure for selecting the best bidder for construction of fishing grounds for fishing waters that are not covered in 2009. Expected by the end of the year they are developed and adopted.	No	2011	
Adoption of the Program for financial support for rural development in 2010.	Yes	2010	
Modification and amendments to the Regulation on the implementation of policies for rural development.	Yes	2010	
Development of Agro-Environmental Program.	Yes	2010	
Establishment of pilot rural network in Republic of Macedonia.	Yes	2010	
Adoption of Regulation on types of activities that can be performed as additional activities in family agricultural households and their scope.	Yes	2010	
Enactment of Monitoring programs of harmful organisms and their implementation.	No	2011	
Establishment of register of producers, importers and distributors of plants, plant products and other objects	Yes	2010	Keep a record, way of conduct the checking of plant health for physical and legal entity which are inserted in register, and content and the way of providing information
Establishment of passports for plants	No	2011-2012	Establishment of total control on plant health in our country. With admittance of Republic of Macedonia to the EU and plant export in



			member-countries in the EU, passports for plants will guarantee the plant health correctness
Professional training of staff who will conduct registration and deregistration of the active substance and plant protection products	Yes	2010-2011	
Enactment of Monitoring programs for plant protection products and their implementation	No	2011-2012	
Enactment and establishment of registers of fertilizer producers, registers for wholesale and retail, whit which will be prescribed the form, content and the way of keep a fertilizer registers in Republic of Macedonia	Yes	2010	
Introduction of the European Common Varietie Catalogue of agricultural plants	No	2011-2013	Diversifying of the varieties assortment of seed and seedling material in the Republic of Macedonia, allocated for export of agricultural plants in EU member countries
Saving varieties of seed and seedling material, as wealth as genetic potential for creating of the new varieties in the Republic of Macedonia through the establishment of a National Gene Bank	Yes	2010	
Modification and amendment to the Law on seeds and seedling material for agricultural plants in 2011	Yes	2010	
Diagnostic and determination of harmful organisms, biological testing examination of physical- chemical characteristic of plant protection product, analysis of active ingredients, seed material analysis.	Yes	2010-2011	Continuously
Better harmonization of needs of technical assistance, more effective coordination of current project activities, and prior to identification of prioritized activities relating to agriculture, rural development, food safety, and veterinary and phytosanitary policy.	Yes	2010-2011	Continuously
A document entitled "Priorities for donor assistance in Sector for agriculture and rural development"	No	2011	In progress
Further alignment of national veterinary legislation to relevant EU acquis	Yes	2010-2011	Continuously
Classification of establishments according to their compliance with relevant EU requirements and standards and defining timetable for their adaptation.	Yes	2010-2011	Continuously
Strengthening of inspection services relating to official controls carrying out to the food chain of animal origin in compliance with relevant EU standards/requirements (IPA component 2)	Yes	2010-2011	Continuously
Establishing the system for animal identification and registration of swine animals (IPA component 5): ear tags and software procurement	No	2011	
Establishing the system for pet animals (dogs and	No	2011	



cats) and bees			
Adoption of all sub-law acts derived from Law on hunting	Yes	2010	
Adoption of all sub-law acts derived from Law on forests	No	2011	In progress
Adoption of the Program of promotion and development of hunting for 2011	No	2011	
Adoption of the Program for extended reproduction of forests for 2010	Yes	2010	
Adoption of the Information forests health condition of the Republic of Macedonia for 2009 with proposed measures	Yes	2010	
<b>Financial Sector</b>			
Law on Financial Companies	Yes	2010	
Law on the National Bank of the Republic of Macedonia	Yes	2010	
Amendments and modifications to the Law on Deposit Insurance Fund	Yes	2010	
Preparation of the Law on Distance Selling of Financial Services	Yes	2010	
Preparation of the Law on Financial Conglomerates	No	2011	
Preparation of the amendments and modifications on the Banking Law	No	2012	
Application of the regulation for capital requirements to cover credit and operational risk, prepared basis of the simple approach of Basel 2	No	2012	
Preparation of regulations for determination of the capital required to cover credit and operational risk, on the basis of the advanced approaches of Basel 2	No	2012	
Amendments and modifications to the Law on Securities	Yes	2010	
<b>Labour market</b>			
Operational Plan for active programs and measures for employment in 2010	Yes	2010	
Evaluation Report on the effects of the implementation of the Programme for the formalization of existing businesses, implemented in 2008	Yes	2010	
Establishment of the Economic and Social Council	Yes	2010	
Amendments and Modifications to the Law Labor Relations	Yes	2010	
Amendments and Modifications to the Employment law and insurance against unemployment	Yes	2010	
Amendments and Modifications to the Law on Temporary Employment Agencies	No	2010	In parliament procedure
Training for employment of adults who did not finished school for the first level of professional qualifications	No	2012	In progress
Pre-qualification and additional training of the employed persons and adults	Yes	2012	Continuously
Analysis of the needs of labor market in order to adjust the qualification profile of the workforce according to the needs of companies	Yes	2010	Continuously



Creating standards of occupation, curriculum and testing programs at the Centre for VET according to the needs of the labor market.	No	2012	In progress
<b>Administrative reform</b>			
Training of civil servants involved in the process of public administration reform	Yes	2010	Continuously
Capacity building of the Unit for Public Administration Reform which is in charge for monitoring the implementation of the Strategy for Public Administration Reform	Yes	2010	Continuously
Public consultation through public debates – draft strategy	Yes	2010	There were five public debates held on 7, 8, and 12 October 2010
Defining priorities based on prior consultations with the public through public debates – draft strategy	Yes	2010	
Adopting a new Strategy for Public Administration Reform – provided by IPA 2007	Yes	2010	
Conduct assessment to determine the impact of regulation	Yes	2010	Continuously
Preparation of training programs and professional training of civil servants at central level	Yes	2010	Continuously
Implementation of Twinning – “Capacity building of the General Secretariat (Sector for Strategy, planning and monitoring, and Sector for policy analysis and coordination) to strengthen Government’s capacity for Strategic planning and monitoring, as well as Policy making and coordination”	Yes	2010	
Introduction of new organs of the portal <a href="http://www.uslugi.gov.mk">www.uslugi.gov.mk</a>	Yes	2010	
Action plan for dispersion of the instrument – citizen charter closer to citizens	Yes	2010	
New law on Citizen associations and foundation and adoption of bylaws	Yes	2010	
Staff training in the Unit for Cooperation with NGOs outside the capital and rural areas	Yes	2011-2013	
Encourage the development of civil society, particularly outside the capital and rural areas	Yes	2011-2013	
<b>Judiciary reforms</b>			
Law on amendments and modifications to the Law on Courts	Yes	2010	
Law on amendments and modifications to the Law on Judicial Council of the Republic of Macedonia	Yes	2010	
Law on amendments and modifications to the Law on Judicial Budget	Yes	2010	
Law on amendments and modifications to the Law on Court Service	Yes	2010	
Law on amendments and modifications to the Law on Litigation	Yes	2010	
Law on Court Expertise	Yes	2010	
Law on amendments and modifications to the Law on	Yes	2010	



Administrative Disputes			
Law on amendments and modifications to the Law on Bar	No	2011	
Law on amendments and modifications to the Law on Misdemeanors	No	2011	
Law on Criminal Procedure	Yes	2010	
Law on International Cooperation in Criminal Matters	Yes	2010	
Law on Academy for Judges and Public Prosecutors	Yes	2010	
Second generation of the initial training for judges and public prosecutors finished	Yes	2010	
Third generation of the initial training for judges and public prosecutors finished	Yes	2010	
Fourth generation of the initial training for judges and public prosecutors finished	No	2012	
Transfer of old enforcement cases	No	2011	
ACCMIS entirely made operational in all courts in the Republic of Macedonia	Yes	2010	
Posting (publishing) of judicial decisions on web pages of courts	Yes	2010	Continuously Currently, there are around 48,000 judicial decisions posted on web – sites of courts
Updating of the data base with laws - LDBIS	Yes	2010	Continuously Currently, there are around 21,000 laws and regulations listed in the data base
Renovation of 11 basic courts with extended competence	Yes	2010	Renovation of 10 courts is entirely finished, while renovation of the Basic Court Bitola will be finished in April 2011
Construction of a new court building -the Criminal Court	No	2011	Underway
<b>Other areas</b>			
Feasibility study on gasification	Yes	2010	
Preparation of project documentation on gasification	No	2011	
MAP of SEETO 2011-2015	Yes	2010	
Treaty for establishing a Transport community between the European Union and the South East European Countries	No		Signing the treaty is expected to happen in the second quarter of 2011, its ratification during the 2011/2012 and entering into force is expected after ratification.
Update is preformed on the National transport strategy	Yes	2010	The next update will be performed in 2012
The Law on the rail system	Yes	2010	
The Law on the safety of the rail system	Yes	2010	
The Law on interoperability of the rail system	No	2011	



National Program for railway infrastructure for period 2011-2013	No	2010	In government procedure
The Law amending the Law on inland navigation	Yes	2010	
The Law amending the Law on Aviation	Yes	2010	
The draft proposal of a law on postal services	Yes	2010	
Strategy for development of the postal services	No	2011	
The Postal Agency is going to complete the secondary legislation that emanates from the Law on postal services by the end of the first quarter of 2011.	No	2011	
A Law amending the Law on electronic communications	Yes	2010	
A Law amending the Law on broadcasting (The adoption of the proposed solutions will provide guarantee, the existence of dual broadcasting system, i.e. the existence of one side of public service broadcasting, on the other side of commercial broadcasting)	Yes	2010	
A Law amending the Law on broadcasting activity (to make a more efficient collection of the broadcasting fee to be performed by the Public Revenue Office)	Yes	2010	
A Law amending the Law on broadcasting activity (implementation of the Directive on audiovisual media services)	No	2011	
Agency for electronic communications began a revision of Rules on access and use of specific network facilities, in order to create a regulatory basis for the joint use of the ducts/channels and associated infrastructure.	No	2011	
Electronic registry -Atlas of telecommunication infrastructure (Project that will collect information's for existing telecommunication infrastructure (underground and over ground).	No	2011-2013	
Revision of the bylaw that is regulating number portability	No	2011-2013	
Analysis of the numeration resources, their utilization and methodology for setting and collection of the charges	No	2011-2013	
Analyzes of the need of imposing regulation for VoIP services.	No	2011-2013	

\*Date of adoption or, alternately, date foreseen

Source: participating institutions in the preparation of 2011 – 2013 PEP





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Participating institutions:

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- Ministry of agriculture, forestry and water management;
- Ministry of justice;
- Ministry of labour and social policy;
- Ministry of education;
- Ministry of transport and communication;
- National Bank of the republic of Macedonia;
- Commission for protection of competition;
- Civil servants Agency;
- General Secretariat of the Government of the Republic of Macedonia;
- Cabinet of the Viceprimeminister for economic issues, Mr. Vladimir Pesevski;
- Agency for supervision of insurance;
- Agency for employment;
- Securities and exchange commission;
- Agency for supervision of fully-funded pension insurance;
- Agency for foreign direct investment and export promotion;
- Secretariat for European affairs;
- Central registry of the Republic of Macedonia.

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